

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

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Court of Appeals of the District of Columbia

JANUARY TERM, 1932

No. 5638

172

**NEW YORK, CHICAGO & ST. LOUIS RAILROAD
COMPANY, APPELLANT,**

vs.

**DAVID BURNET, COMMISSIONER OF INTERNAL
REVENUE.**

APPEAL FROM THE BOARD OF TAX APPEALS.

FILED MARCH 19, 1932.

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Court of Appeals of the District of Columbia

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COMPANY, APPELLANT,

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DAVID BURNET, COMMISSIONER OF INTERNAL
REVENUE.

APPEAL FROM THE BOARD OF TAX APPEALS.

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Court of Appeals of the District of Columbia

No. 5638.

NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Appellant,

vs.

DAVID BURNET, Commissioner of Internal Revenue.

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Docket No. 21047.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Appearances:

For Petitioner: Chester A. Gwinn, Esq., (Withdrawn),
Adrian C. Humphreys, Esq., Newton K. Fox, Esq.

For Respondent: A. H. Murray, Esq., E. C. Algire, Esq.

Docket Entries.

1926.

Nov. 4. Petition received and filed. Taxpayer notified.

Nov. 5. Copy of petition served on General Counsel.

1927.

Jan. 4. Motion to extend time to 2/3/27 to answer filed
by General Counsel.

Jan. 10. Granted—both sides notified.

Feb. 3. Answer filed by General Counsel.

Mar. 7. Copy of answer served on taxpayer—assigned
general calendar.

June 6. Motion to amend petition filed by taxpayer—
amendment tendered.

1927.

- June 7. Copy of motion and amended petition served on General Counsel.
- Aug. 6. Motion for an extension of time to 9/5/27 to answer filed by General Counsel.
- Aug. 8. Granted—both sides notified.
- Sept. 3. Answer to amended petition filed by General Counsel.
- Sept. 6. Copy served on taxpayer—General Calendar.
- Sept. 9. Motion to strike certain portions of respondent's answer to amended petition filed by taxpayer.
- Sept. 14. Hearing date set Oct. 4, 1927 on motion.
- Oct. 4. Hearing had before Mr. Smith—by agreement motion continued for 30 days.
- Oct. 4. Order of continuance to 11/8/27 signed and filed—both sides notified.
- Nov. 8. Hearing had before Mr. Milliken on petitioner's motion to strike answer. Respondent asked time to amend—granted.
- Nov. 8. Order granting motion of 9/9/27 and giving respondent 30 days to amend answer—signed and filed. Both sides notified.
- Dec. 8. Answer to paragraphs 5(*d*) and (*g*) of the petition filed by General Counsel.
- Dec. 14. Copy of answer served on taxpayer—General Calendar.

1928.

- Dec. 6. Hearing date set Jan. 9, 1929.

1929.

- Jan. 4. Motion for transfer to reserve calendar filed by General Counsel. Granted 1/5/29.

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1930.

- Aug. 14. Stipulation of facts filed.
- Oct. 4. Motion to place on the day calendar filed by taxpayer 10/6/30 granted and set for hearing 10/30/30.
- Oct. 7. Hearing set Oct. 30, 1930.
- Oct. 30. Hearing had before Mr. Sternhagen—submitted. Stipulation of facts offered and received in evidence. Briefs due Dec. 3, 1930. No exchange.
- Nov. 12. Transcript of hearing of Oct. 30, 1930 filed.

Nov. 29. Request for findings of fact and brief filed by taxpayer.

Dec. 1. Brief filed by General Counsel.
1931.

May 13. Stipulation of facts and opinion rendered—John M. Sternhagen, Division 10. Judgment will be entered under Rule 50.

July 15. Notice of settlement filed by General Counsel.

July 29. Hearing set Aug. 19, 1931 on settlement.

Aug. 5. Consent to settlement filed by taxpayer.

Aug. 18. Judgment entered—John M. Sternhagen, Division 10.

Nov. 30. Motion to set aside final order filed by General Counsel. 12/7/31 granted.

1932.

Jan. 19. Notice of withdrawal of Chester A. Gwinn and the appearance of Adrian C. Humphreys as counsel filed.

Jan. 19. Consent to modification of report and judgment filed by taxpayer.

Jan. 19. Order modifying report and judgment entered—John M. Sternhagen, Division 10.

Jan. 27. Stipulation to have case reviewed by the Court of Appeals of D. C. filed.

Feb. 4. Petition for review to Court of Appeals of D. C. with assignments of error filed by taxpayer.

Feb. 4. Proof of service filed.

Feb. 4. Notice of appearance of Newton H. Fox as counsel filed.

Feb. 23. Præcipe with proof of service thereon filed.

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Filed Nov. 4, 1926.

United States Board of Tax Appeals.

Docket No. 21047.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition.

The above named petitioner hereby petitions for a redemption of the deficiency set forth by the Commissioner

of Internal Revenue in his notice of deficiency bearing the symbols IT:CR:RR-60D-FW, dated September 21, 1926, and as a basis of its proceeding alleges, as follows:

1. The petitioner is a corporation with principal office at Cleveland, Ohio.

2. The notice of deficiency, a copy of which is attached and marked Exhibit "A", was mailed to the petitioner on September 21, 1926.

3. The tax in controversy is income tax for the calendar year 1917 and is for \$3,562.26.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

4 (a) The respondent erred in failing and refusing to allow as a deduction from gross income a proportionate part of the discount sustained in connection with the sale of Gold Bonds of 1906, said discount aggregating \$350,000.00 having been charged to profit and loss account, the aliquot portion of which amounts to \$15,433.96 annually.

(b) The respondent erred in failing and refusing to allow as a deduction from gross income a proportionate part of the discount incurred in connection with the issuance of First Mortgage Bonds, the aliquot portion of which amounts to \$38,196.60 annually.

(c) The respondent erred in including as taxable net income an amount of \$16,958.34 representing discount involved in the purchase of petitioner's own First Mortgage Bonds for cancellation at less than par.

(d) The respondent erred in including as taxable net income an amount of \$41,738.84 representing rental which accrued to the petitioner prior to the taxable year.

(5) The facts upon which the petitioner relies as the basis of this proceeding are, as follows:

(a) That the petitioner is a railroad corporation and was organized on September 27, 1887 under the laws of the States of New York, Pennsylvania, Ohio and Indiana.

5 (b) That at different dates during the calendar years 1907 and 1908 petitioner issued its Gold Bonds of 1906 dated May 1, 1906 maturing May 1, 1931, to the extent of \$10,000,000.00 par value. The proceeds from the sale of said bonds aggregated \$9,500,000.00, the difference of \$500,000.00 representing a discount resulting from the sale at less than par. The discount of \$500,000.00 was charged in petitioner's books, as follows:

\$150,000.00 to property account.

\$350,000.00 to profit and loss (or surplus) account.

(c) The respondent has allowed as a deduction from gross income an amount of \$6,206.88 representing amortization of such portion of the discount in connection with the sale of Gold Bonds of 1906 as was charged to property account (\$150,000) but has denied petitioner a deduction for any portion of such discount as was charged to profit and loss (or surplus) account.

(d) Under the terms of the "Agreement of Purchase and Reorganization" dated February 4, 1887, petitioner issued its First Mortgage 4% Bonds aggregating \$17,955,830.00 par value to refund existing First Mortgage 6% Bonds aggregating \$15,000,000.00 par value, and Second Mortgage 6% Bonds aggregating \$1,046,000.00 par value, or a total par value of bonds refunded of \$16,046,000.00.

(e) The respondent has denied petitioner a deduction representing amortization of discount on First Mortgage 4% Bonds, said discount amounting to \$1,909,830.00 determined by the difference between the par value of First Mortgage Bonds issued (\$17,955,830.00) and the par value of bonds refunded (\$16,046,000.00). Said First
6 Mortgage Bonds were dated October 1, 1887 and mature October 1, 1937. Said discount of \$1,909,830.00 spread over the life of the bonds results in an annual proportion of \$38,196.60.

(f) During the year 1917 petitioner purchased for retirement its First Mortgage Bonds to the extent of \$116,000.00 par value at a cost of \$99,041.66. The difference between par value (\$116,000.00) and the price at which they were purchased by petitioner (\$99,041.66) amounts to \$16,958.34 which is included in taxable net income as finally determined by respondent.

(g) Under an agreement between the City of Cleveland and the petitioner, the cost of eliminating certain grade crossings on the West Side of Cleveland was to be borne in part by the City, the balance to be borne by the petitioner. During the years 1914, 1915 and 1916 rentals were received from various tenants of property acquired in connection with said grade elimination in the amounts \$26,862.29, \$9,786.09 and \$5,090.46, respectively. Said amounts were credited on petitioner's books to a suspense account and remained in said suspense account until 1917 at which time

the entire amount aggregating \$41,738.84, was transferred to profit and loss (or surplus) account.

(h) That claim for refund for the year 1917 amounting to \$4,978.84 was filed with the Collector of Internal Revenue, Cleveland, Ohio, on or about March 8, 1923, and that said claim was filed within the statutory period of limitation.

Wherefore the petitioner prays that this Board
7 may hear the proceeding and determine

(1) That the alleged deficiency is erroneous and should be eliminated.

(2) That a refund of tax is due the petitioner.

(S.) CHESTER A. GWINN,
CHESTER A. GWINN.

CHESTER A. GWINN,
% *Humphreys & Day, Munsey Building,*
Washington, D. C.,
Counsel for Taxpayer.

8 STATE OF OHIO,
County of Cuyahoga, ss:

W. A. Colston, being duly sworn says that he is the Vice-President and General Counsel of The New York, Chicago & St. Louis Railroad Company, the petitioner above-named, and as such he is duly authorized to verify the foregoing petition; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

(S.) W. A. COLSTON.

Subscribed and sworn to before me this 26th day of October, 1926.

(S.) ELMER C. HOLBERG,
Notary Public.

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Form N. P.-2.

EXHIBIT "A".

Treasury Department, Washington.

IT:CR:RR-60D. FW.

Mailed Sep. 21, 1926.

The New York, Chicago and St. Louis Railroad Company,
East Second Street and Prospect Avenue, Cleveland,
Ohio.

SIRS:

A reexamination of your income and profits tax returns discloses a deficiency in tax for the year 1917 amounting to \$3,562.26 as shown in the attached statement and accompanying schedules.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:CR:RR-60D. FW. In the event that you

acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner,

(Signed)

By C. R. NASH,
Assistant to the Commissioner.

Inclosures: Statement, Form A, Schedules 1 to 2, inclusive.

10 IT:CR:RR-60D. FW.

Statement of Returns Examined and Resulting Tax Liability.

Returns Examined.

Name of company.	Year.	Form.
The New York, Chicago and St. Louis Railroad Company, East Second Street and Prospect Ave., Cleveland, Ohio...	1917	1090-1103

Tax Liability.

Name of company.	Year.	Additional tax.
The New York, Chicago and St. Louis Railroad Company, East Second Street and Prospect Ave., Cleveland, Ohio...	1917	\$3,562.26

Full details of the adjustments producing the above stated results are contained in Schedules 1 to 2, inclusive.

In this final determination of your tax liability as shown above due consideration has been given to the statements made in your protest dated June 24, 1924, and in your claims for refund of \$4,623.96 and \$1,017.50, respectively, which claims will be made the subject of separate communications from this office.

Waiver which will expire December 31, 1926, is on file for the year 1917.

In accordance with decision in conference in this office November 3, 1925, based upon the facts developed from

your books of account and records, and the various data submitted by you, the following items adjusted by the Bureau, to which adjustments you have made objection, and other items which you have claimed are disallowed, as follows:

11 The New York, Chicago and St. Louis Railroad Company.

Year Ended December 31, 1917.

SCHEDULE 1.

Net Income.

Net income as disclosed by Bureau letter dated May 23, 1924.....	\$1,026,500.43
As corrected.....	1,013,917.31
Deduction	\$12,583.12
Deduction:	
(a) Profit on land sold.....	\$12,583.12
Total deduction as above.....	\$12,583.12

SCHEDULE 1-A.

(a) Consideration has been given to the additional information submitted by you with respect to the taxable profit on land sold in 1917 and upon the basis of this data, decision has been reached as to the amount of profit which should be taxed. A computation follows:

Sale price of property in 1917.	\$17,545.95	
Less expense of sale.....	10.00	
		\$17,535.95
March 1, 1913, value as per affidavits.....		15,596.40
Taxable profit.....		1,939.55
Profit reported in return.....		14,522.67
Deduction from income.....		\$12,583.12

SCHEDULE 2.

Computation of Total Tax (1917).

		Tax.
Net income (Schedule 1).....	\$1,013,917.31	
Taxable at 2%.....	1,013,917.31	\$20,278.35
Taxable at 4%.....	1,013,917.31	40,556.69
Total		\$60,835.04
Previously assessed:		
Original return.....	51,576.53	
Bureau letter dated January 8, 1923	5,696.25	
		57,272.78
Additional tax to be assessed.....		\$3,562.26

Since the excess profits credit is in excess of the taxable income there is no excess profits tax.

12 The New York, Chicago & St. Louis Railroad Company.

Income 1917.

Your protest dated June 4, 1924:

Item 1. Amortization of discount on Gold Bonds of 1906	\$21,640.84
Item 2. Amortization on discount on First Mort- gage Bonds	35,045.38
Item 3. Adjustment of profit on retirement of First Mortgage Bonds.....	4,596.96
Item 5. Adjustment of rental from property....	39,808.69

With respect to Item 1, the amount represents discount on bonds charged to profit and loss prior to 1909, and the Unit has consistently disallowed such items, in accordance with Article 149, Regulations 33 (Revised), A. R. R. 394, Cumulative Bulletin 4, page 391, and Mimeograph 3227, Cumulative Bulletin III-2, page 245.

Your contention in Item 2 that the excess of bonds issued by the new company over the par value of the bonds of the

old company outstanding constitutes discount is not agreed to. The Unit holds that the bonds issued by the new company were in payment for the property, and that no amortizable discount was suffered.

Item 3 is contingent upon the allowance of Item 2, and is, therefore, denied.

Item 5 represents rentals received by you from West Side Grade Elimination property and credited to a balance sheet account. Prior to the year 1917 affidavits filed by you state in effect, that it was not known whether the City of Cleveland would participate in these rentals, but in that year the amount accrued was cleared to the profit and loss account of your company. It appears, therefore, that the first time these rentals could be determined to belong to your company was in 1917, and the amount is held to be income in that year.

A carbon of this letter has been mailed to Humphreys and Day in accordance with the authorization contained in your power of attorney dated August 14, 1922 running to them, which is on file in this office.

13 Filed Feb. 3, 1927, United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 21047.

NEW YORK, CHICAGO & ST. LOUIS R. R. Co., Cleveland, Ohio,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Answer.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1. Admits the allegations in said paragraph of the petition.

2. Admits the allegations in said paragraph of the petition.

3. Admits the allegations in said paragraph of the petition.

5. (a) Admits the allegations in said paragraph of the petition.

(b) Admits that in 1907 the petitioner issued gold bonds of 1906 maturing May 1, 1931 and received as the proceeds \$500,000.00 less than the principal amount of said bonds. Admits that said discount of \$500,000.00 was charged in the petitioner's books in the respective amounts of \$150,000.00 to property account and \$350,000.00 to profit and loss account.

(c) Admits the allegations in said paragraph of the petition.

(d) Admits that at its incorporation in 1887, the petitioner issued first mortgage 4% bonds for certain property of a predecessor corporation but denies that said bonds were issued to refund any bonds or other obligations of the petitioner.

14 (e) Admits that the respondent has disallowed a deduction taken by the petitioner in the amount of \$38,196.60 for amortization of the alleged discount on said first mortgage bonds.

(f) Admits the allegations in said paragraph of the petition.

(g) Admits that on account of controversies with the city of Cleveland, the rentals from certain property for years prior to 1917 were credited on the petitioner's books to a suspense account and that in 1917 the amount of such rents was transferred to the profit and loss account of the petitioner. Denies the other allegations in said paragraph of the petitioner.

(h) Admits that a claim for refund for the year 1917 was filed on or about March 8, 1923, within the statutory period of limitation. Denies that the amount of said claim was \$4,978.84.

Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified, or denied.

Wherefore it is prayed that the taxpayer's appeal be denied.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

THOMAS P. DUDLEY, JR.,
Special Attorney,
Bureau of Internal Revenue.

15 Filed Jun. 6, 1927, United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 21047.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Motion to File Amended Petition.

Now comes The New York, Chicago & St. Louis Railroad Company, the petitioner in the above-mentioned case, and by its attorney moves for leave to file the amended petition attached hereto.

CHESTER A. GWINN,
c/o Humphreys & Day,
Munsey Building, Washing-
ton, D. C., Attorney for the
Petitioner.

16 United States Board of Tax Appeals.

Docket No. 21047.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Amended Petition.

The above-named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency bearing the symbols IT:CR:RR-60D-FW, dated September 21, 1926, and as a basis of its proceeding alleges, as follows:

1. The petitioner is a corporation with principal office at Cleveland, Ohio.

2. The notice of deficiency, a copy of which is attached and marked Exhibit "A", was mailed to the petitioner on September 21, 1926.

3. The tax in controversy is income tax for the calendar year 1917 and is for \$3,562.26.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

17 (a) The respondent erred in failing and refusing to allow as a deduction from gross income a proportionate part of the discount sustained in connection with the sale of Gold Bonds of 1906, said discount aggregating \$350,000.00 having been charged to profit and loss account, the aliquot portion of which amounts to \$15,433.96 annually.

(b) The respondent erred in failing and refusing to allow as a deduction from gross income a proportionate part of the discount incurred in connection with the issuance of First Mortgage Bonds, the aliquot portion of which amounts to \$38,196.60 annually.

(c) The respondent erred in including as taxable net income an amount of \$16,958.34 representing discount involved in the purchase of petitioner's own First Mortgage Bonds for cancellation at less than par.

(d) The respondent erred in including as taxable net income an amount of \$41,738.84 representing rental which accrued to the petitioner prior to the taxable year.

(e) The respondent erred in failing and refusing to allow as a deduction from gross income for 1917 the net expense of operating petitioner's Bellevue and Stony Island ice houses during said year in the respective amounts of \$8,409.17 and \$1,211.18, or a total of \$9,620.35.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) That the petitioner is a railroad corporation and was organized on September 27, 1887 under the laws of the States of New York, Pennsylvania, Ohio and Indiana.

18 (b) That at different dates during the calendar years 1907 and 1908 petitioner issued its Gold Bonds of 1906 dated May 1, 1906 maturing May 1, 1931, to the extent of \$10,000,000.00 par value. The proceeds from the sale of said bonds aggregated \$9,500,000.00, the difference of \$500,000.00 representing a discount resulting from the sale at less than par. The discount of \$500,000.00 was charged in petitioner's books, as follows:

\$150,000.00 to property account.

\$350,000.00 to profit and loss (or surplus) account.

(c) The respondent has allowed as a deduction from gross income an amount of \$6,206.88 representing amortization of such portion of the discount in connection with the sale of Gold Bonds of 1906 as was charged to property account (\$150,000) but has denied petitioner a deduction for any portion of such discount as was charged to profit and loss (or surplus) account.

(d) Under the terms of the "Agreement of Purchase and Reorganization" dated February 4, 1887, petitioner issued its First Mortgage 4% Bonds aggregating \$17,955,830.00 par value to refund existing First Mortgage 6% Bonds aggregating \$15,000,000.00 par value, and Second Mortgage 6% Bonds aggregating \$1,046,000.00 par value, or a total par value of bonds refunded of \$16,046,000.00.

(e) The respondent has denied petitioner a deduction representing amortization of discount on First Mortgage 4% Bonds, said discount amounting to \$1,909,830.00 determined by the difference between the par value of
19 First Mortgage Bonds issued (\$17,955,830.00) and the par value of bonds refunded (\$16,046,000.00). Said First Mortgage Bonds were dated October 1, 1887 and mature October 1, 1937. Said discount of \$1,909,830.00 spread over the life of the bonds results in an annual proportion of \$38,196.60.

(f) During the year 1917 petitioner purchased for retirement its First Mortgage Bonds to the extent of \$116,000.00 par value at a cost of \$99,041.66. The difference between par value (\$116,000.00) and the price at which they were purchased by petitioner (\$99,041.66) amounts to \$16,958.34 which is included in taxable net income as finally determined by respondent.

(g) Under an agreement between the City of Cleveland and the petitioner, the cost of eliminating certain grade crossings on the West Side of Cleveland was to be borne in part by the City, the balance to be borne by the petitioner. During the years 1914, 1915 and 1916 rentals were received from various tenants of property acquired in connection with said grade elimination in the amounts \$26,862.29, \$9,786.09 and \$5,090.46, respectively. Said amounts were credited on petitioner's books to a suspense account

and remained in said suspense account until 1917 at which time the entire amount aggregating \$41,738.84, was transferred to profit and loss (or surplus) account.

(h) The results of operating petitioner's Bellevue and Stony Island ice houses were carried as suspense accounts from 1912 and 1916 respectively and until November 30, 1918, at which time the balance in each account was charged to profit and loss (or surplus) account, and deducted from gross income in petitioner's return for 1918. Respondent has denied the deduction for 1918 on the basis that the expense relates to previous years. The amounts alleged in paragraph 4 (e) of this petition are obtained as follows:

	Bellevue.	Stony Island.
Debit balance December 31, 1917 . . .	\$13,631.67	\$2,125.37
“ “ January 1, 1917	5,222.50	914.19
Increase in debit balance (net expense)	\$8,409.17	\$1,211.18
Total increase in debit balance (net expense) . . .		\$9,620.35

(i) That claim for refund for the year 1917 amounting to \$4,978.84 was filed with the Collector of Internal Revenue, Cleveland, Ohio, on or about March 8, 1923, and that said claim was filed within the statutory period of limitation.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine

1. That the alleged deficiency is erroneous and should be eliminated.

2. That a refund of tax is due the petitioner.

CHESTER A. GWINN,
% *Humphreys & Day, Munsey Building,*
Washington, D. C., Counsel for Taxpayer.

21 STATE OF OHIO,
County of Cuyahoga, ss:

W. A. Colston, being duly sworn says that he is the Vice-President and General Counsel of The New York, Chicago & St. Louis Railroad Company, the petitioner above-named, and as such he is duly authorized to verify the foregoing

petition; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

(S.)

W. A. COLSTON.

Subscribed and sworn to before me this 3rd day of June, 1927.

(S.)

—— — (illegible),
Notary Public.

22

EXHIBIT "A".

Form N. P.-2.

Treasury Department, Washington.

IT:CR:RR-60D. FW.

Mailed Sep. 21, 1926.

The New York, Chicago and St. Louis Railroad Company,
East Second Street and Prospect Avenue, Cleveland
Ohio.

SIRS:

A reexamination of your income and profits tax returns discloses a deficiency in tax for the year 1917 amounting to \$3,562.26 as shown in the attached statement and accompanying schedules.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a peti-

tion and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:CR:RR-60D-FW. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner,

(Signed)

By C. R. NASH,
Assistant to the Commissioner.

Inclosures: Statement, Form A, Schedules 1 to 2, inclusive.

23 IT:CR:RR-60D. FW.

Statement of Returns Examined and Resulting Tax Liability.

Returns Examined.

Name of company.	Year.	Form.
The New York, Chicago and St. Louis Railroad Company, East Second Street and Prospect Avenue, Cleveland, Ohio	1917	1090-1103

Tax Liability.

Name of company.	Year.	Additional tax.
The New York, Chicago and St. Louis Railroad Company, East Second Street and Prospect Ave., Cleveland, Ohio...	1917	\$3,562.26

Full details of the adjustments producing the above stated results are contained in Schedules 1 to 2, inclusive.

Waiver which will expire December 31, 1926, is on file for the year 1917.

24 The New York, Chicago & St. Louis Railroad
 Company.

Your protest dated June 4, 1924:

With respect to Item 1, the amount represents discount on bonds charged to profit and loss prior to 1909, and the Unit has consistently disallowed such items, in accordance with Article 149, Regulations 33 (Revised), A. R. R. 394, Cumulative Bulletin 4, page 391, and Mimeograph 3227, Cumulative Bulletin III-2, page 245.

Item 3 is contingent upon the allowance of Item 2, and is therefore, denied.

Item 5 represents rentals received by you from West Side Grade Elimination property and credited to a balance

sheet account. Prior to the year 1917 affidavits filed by you state in effect, that it was not known whether the City of Cleveland would participate in these rentals, but in that year the amount accrued was cleared to the profit and loss account of your company. It appears, therefore, that the first time these rentals could be determined to belong to your company was in 1917, and the amount is held to be income in that year.

A carbon of this letter has been mailed to Humphreys and Day in accordance with the authorization contained in your power of attorney dated August 14, 1922 running to them, which is on file in this office.

25 The New York, Chicago & St. Louis Railroad Co.
Year Ended December 31, 1917.

SCHEDULE 1.

Net Income.

Net income as disclosed by Bureau letter dated May 23, 1924.....	\$1,026,500.43
As corrected.....	1,013,917.31
Deduction	\$12,583.12
Deduction:	
(a) Profit on land sold.....	\$12,583.12
Total deduction as above.....	\$12,583.12

SCHEDULE 1-A.

(a) Consideration has been given to the additional information submitted by you with respect to the taxable profit on land sold in 1917 and upon the basis of this data, decision has been reached as to the amount of profit which should be taxed. A computation follows:

Sale price of property in 1917.	\$17,545.95	
Less expense of sale.....	10.00	
		\$17,535.95
March 1, 1913 value as per affidavits.....		15,596.40
Taxable profit.....		1,939.55
Profit reported in return.....		14,522.67
Deduction from income.....		\$12,583.12

SCHEDULE 2.

Computation of Total Tax (1917).

		Tax.
Net income (Schedule 1).....	\$1,013,917.31	
Taxable at 2%.....	1,013,917.31	\$20,278.35
Taxable at 4%.....	1,013,917.31	40,556.69
Total		\$60,835.04
Previously assessed:		
Original return.....	51,576.53	
Bureau letter dated Janu- ary 8, 1923.....	5,696.25	
		57,272.78
Additional tax to be assessed.....		\$3,562.26

Since the excess profits credit is in excess of the taxable income there is no excess profits tax.

26 Filed Sep. 3, 1927, United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 21047.

NEW YORK, CHICAGO & ST. LOUIS R. R. Co., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Answer to Amended Petition.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the amended petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations in said paragraph of the amended petition.

(2) Admits the allegations in said paragraph of the amended petition.

(3) Admits the allegations in said paragraph of the amended petition.

(5) (a) Admits the allegations in said paragraph of the amended petition.

(b) Admits that in 1907 the petitioner issued gold bonds of 1906 maturing May 1, 1931 and received as the proceeds \$500,000.00 less than the principal amount of said bonds. Admits that said discount of \$500,000.00 was charged in the petitioner's books in the respective amounts of \$150,000.00 to property account and \$350,000.00 to profit and loss account.

(c) Admits the allegations in said paragraph of the amended petition.

(d) Admits that at its incorporation in 1887, the petitioner issued first mortgage 4% bonds for certain property of a predecessor corporation but denies that said bonds were issued to refund any bonds or other obligations of the petitioner.

27 (e) Admits that the respondent has disallowed a deduction taken by the petitioner in the amount of \$38,196.60 for amortization of the alleged discount on said first mortgage bonds.

(f) Admits the allegations in said paragraph of the amended petition.

(g) Admits that on account of controversies with the City of Cleveland, the rentals from certain property for years prior to 1917 were credited on the petitioner's books to a suspense account and that in 1917 the amount of such rents was transferred to the profit and loss account of the petitioner. Denies the other allegations in said paragraph of the petitioner.

(h) Admits that the results of operating petitioner's Bellevue and Stony Island ice houses were carried as suspense accounts from 1912 and 1916 respectively, and until November 30, 1918, at which time the balance in each account was charged to profit and loss (or surplus) account, and deducted from gross income in petitioner's return for 1918. Admits that the respondent has denied the deduction for 1918 on the basis that the expense relates to previous years. For want of knowledge or information sufficient to form a belief, except as in and by the petition informed, neither admits nor denies that the debit balances, if any,

in the Bellevue and Stony Island accounts at December 31, 1917 or at January 1, 1917, were the respective amounts alleged in this paragraph of the petition, and calls for proof thereof.

(i) Admits that a claim for refund for the year 1917 was filed on or about March 8, 1923, within the statutory period of limitation. Denies that the amount of said claim was \$4,978.84.

Denies generally and specifically each and every allegation of the amended petition not hereinbefore admitted, qualified or denied.

28 Wherefore it is prayed that the appeal be denied.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

THOS. P. DUDLEY, JR.,
Special Attorney,
Bureau of Internal Revenue.

29 Filed Dec. 8, 1927, United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 21047.

NEW YORK, CHICAGO & ST. LOUIS R. R. Co., Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Answer to Paragraphs 5 (d) and 5 (g) of the Petition.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, in compliance with the order of the Board dated November 8, 1927, for answer to paragraphs 5 (d) and 5 (g) of the petition admits and denies as follows:

5 (d) Admits that petitioner issued its first mortgage 4% bonds. For want of knowledge or information sufficient to form a belief, except as in and by the petition informed, neither admits nor denies the other allegations in this petition but calls for proof thereof.

5 (g) Admits that in 1917 an amount of \$41,738.84 was carried on the books of the petitioner as a credit in a suspense account and that in said year said amount of \$41,738.84 was transferred to profit and loss or surplus account. For want of knowledge or information sufficient to form a belief, except as in and by the petition informed, neither admits nor denies the other allegations in said petition but calls for proof thereof.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

THOMAS P. DUDLEY, JR.,
Special Attorney,
Bureau of Internal Revenue.

TPD/bs.

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23 B. T. A. —.

United States Board of Tax Appeals.

Docket No. 21047.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD CO.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Promulgated May 13, 1931.

1. A railroad, having defaulted in payment of interest on its outstanding bonds, its property was decreed to be sold as an entirety to discharge the bonds, and compliance with the decree was effected through a reorganization. The property was sold to a committee representing bondholders, creditors, and stockholders, and the committee conveyed it to several corporations organized to operate the property for a fixed price payable in stock and notes. The latter corporations were in turn consolidated and their stock, which was held by the committee, was exchanged par for par for the stock of the consolidated company, and the stock of the latter was distributed among the participating stock-

holders of the old corporation. The consolidated company thereupon issued to the committee its mortgage bonds secured by the property acquired, in satisfaction of such part of the purchase price as was not paid in stock of the underlying corporations, and the committee distributed new bonds to some of the old bondholders of a par value in excess of the par value of the old bonds surrendered. All of these steps were taken pursuant to a plan of reorganization formulated before actual sale of the property under decree of court. The evidence did not disclose whether the old bonds were issued at a discount or whether there was, at the time of the transaction, any unamortized discount, or whether the new bond issue was greater in face amount than the value of the property would justify as principal. *Held*, that difference between the par value of the new bonds distributed to the old bondholders and the par value of the old bonds surrendered was not discount, and the consolidated company, which was on the accrual basis, was not entitled to deduct any part thereof by way of amortization. *Western Maryland Railway Co. v. Commissioner*, 33 Fed. (2d) 695, distinguished.

2. The new corporation which purchases some of the aforesaid bonds for less than their face value, realizes no taxable gain.

3. Where rentals from property are received, apparently contemporaneously with the tenant's occupancy, and the evidence casts no doubt on the recipient's ownership of the rentals when received beyond its own uncertainty about a possible claim of ownership of part of them by another, no part of such rentals may be regarded as income for a later year in which they were transferred from a suspense account to profit and loss and reported in the return as income.

Chester A. Gwinn, Esq., for the petitioner.

E. C. Algire, Esq., for the respondent.

The respondent determined a deficiency in income tax for 1917 in the amount of \$3,562.26. The petition alleges error of the respondent as follows: (1) The disallowance of a deduction of \$15,433.96, representing amortization of a portion of the discount resulting from the sale at less than par of petitioner's bonds of 1906, which was charged to profit and loss. This issue has been eliminated by respondent's concession. (2) The disallowance of

a deduction of \$38,196.60, subsequently modified to \$35,045.38, representing a proportionate part of alleged discount incurred in connection with the issuance of its first mortgage bonds of 1887. (3) The inclusion in income of \$16,958.34, representing alleged gain involved in the purchase by petitioner of some of the aforesaid first mortgage bonds of 1887 at less than par. (4) The inclusion in income of \$41,738, representing rentals which accrued to the petitioner prior to the taxable year. (5) The disallowance of a deduction of \$9,620.35, representing the net expense of operating petitioner's ice houses during the taxable year. This issue has been eliminated by respondent's concession. The facts have been stipulated as follows:

Stipulation of Facts.

1. The petitioner is a railroad corporation organized September 27, 1887, under the laws of the States of New York, Pennsylvania, Ohio, and Indiana, with its principal office at Cleveland, Ohio. It was created by a consolidation of The New York, Chicago & St. Louis Railroad Company, a corporation existing under the laws of the States of New York and Pennsylvania, The Cleveland & State Line Railroad Company, a corporation existing under the laws of the State of Ohio, The Ft. Wayne & Illinois Railroad Company, a corporation existing under the laws of the State of Indiana, and The Erie & State Line Railroad Company, a corporation existing under the laws of Pennsylvania.

2. The petitioner keeps its books on an accrual basis and in accordance with rules prescribed by the Interstate Commerce Commission, and rendered its return for the calendar year 1917 on an accrual basis.

32 3. Omitted because it relates to a question no longer in issue.

4. On January 4, 1887, a receiver having been theretofore appointed for The New York, Chicago & St. Louis Railway Company, hereinafter called Railway Company, and the payment of interest due on its first and second mortgage bonds being in default, the Circuit Court in and for the County of Cuyahoga, State of Ohio, ordered, adjudged and decreed that the condition contained in the mortgages securing the aforesaid bonds having been broken, the principal of said bonds thereby became due and payable together with all accrued interest thereon remaining unpaid. Thereafter,

on or about April 4, 1887, the Railway Company was ordered to pay to the Clerk of the Court within ten days the amount of the principal and interest due on the aforesaid bonds and that in default of such payment an order of sale should be issued to the Special Master Commissioner who was therein appointed, commanding him to sell the properties of the Railway Company as an entirety and without appraisal in accordance with law for not less than \$16,000,000 of which not less than \$100,000 should be paid in cash and the balance as directed by the Court. It was also provided that the purchaser of the said Railway Company's properties at such sale should have the right to satisfy the remainder of the purchase price, over and above the amount which was required to be paid in cash, by paying over and surrendering certain indebtedness of the receiver, and first and second mortgage bonds and interest thereon in default, at such price or value as was equivalent to the amount that the holders thereof would be entitled to receive if the amount of the purchase price was paid in cash. It was provided that the purchaser of the properties at such sale

33 should hold said properties free and discharged from the liens and incumbrances of the mortgages securing the first and second mortgage bonds. The Circuit Court further ordered that a special mandate be sent to the Court of Common Pleas to carry this judgment into execution.

On February 4, 1887, an agreement was entered into for the purchase and reorganization of the Railway Company as follows:

Agreement made this fourth day of February, 1887, by and between the undersigned, holders of the First Mortgage Bonds and overdue coupons thereon, of the New York, Chicago and St. Louis Railway Company (hereinafter, for brevity, designated as "said Railway Company"), holders of the Second Mortgage Bonds of said Railway Company and overdue coupons thereon, and holders of the capital stock, preferred and common, of said Railway Company, who have assented on behalf of themselves and those who shall hereafter join in and assent to this agreement by depositing their securities as hereinafter provided, parties of the first part; the Lake Shore and Michigan Southern Railway Company, and other creditors of said Railway

Company in like situation, who have assented on behalf of themselves and those who shall hereafter join in and assent to this agreement by depositing their evidences of debt and transferring their claims as hereinafter provided, parties of the second part; James A. Roosevelt, John S. Kennedy, Adrian Iselin, Jr., D. Willis James and Oliver Harriman as a committee heretofore appointed by an agreement dated November 21, 1885, of holders of First Mortgage Bonds of said Railway Company, parties of the third part; and Frederic P. Olcott, William K. Vanderbilt, James A. Roosevelt and John S. Kennedy, as a committee appointed by said parties of the first and second parts for the purpose of securing a sale of the property of said Railway Company, and its conveyance to a new corporation hereinafter provided for, and for other purposes, and hereinafter described and designated as the "Purchasing Committee," parties of the fourth part.

The said parties, for and in consideration of the agreements hereinafter contained, and the sum of one dollar by each one of said parties to the other in hand paid, the receipt whereof is hereby acknowledged, each signer agreeing for himself and not incurring any obligation for any other thereby, agree as follows, to wit:

34 First. That the said Frederic P. Olcott, William K. Vanderbilt, James A. Roosevelt, and John S. Kennedy be and they are hereby appointed a Purchasing Committee, to exercise the powers and perform the duties hereinafter set forth, and they consent to act in that capacity.

Second. The said Purchasing Committee shall have power, from time to time to add to the number of its members and to fill any vacancy occasioned by death, resignation, or otherwise. They may act by a majority of their number either at a regular or special meeting convened on notice, or by writing, signed by such majority, without a formal meeting.

Third. They shall, by any and all legal and proper means, procure or cause to be procured a sale of all the property of said Railway Company as an entirety under the decree or decrees of a Court or Courts of competent jurisdiction, and for the purposes of this agreement they may assist in the prosecution of or become parties to all suits now pend-

ing or which may hereafter be brought, or commence and prosecute all such other suits or proceedings as they may deem necessary in the premises, and at any sale of the said property of said Railway Company, or any part thereof, they may purchase and bid in the same, and they are hereby authorized and empowered to bid and pay for the said property and premises such amount as in their judgment may be necessary to protect the interests of the parties hereto.

Fourth. The Purchasing Committee shall cause a new corporation to be formed and incorporated under the laws of the several States of Ohio, Indiana, Illinois, New York and Pennsylvania, or any one or more of said States, having power to acquire all the property and franchises which the said Purchasing Committee may purchase at such sale. In case said Purchasing Committee shall determine to organize such new corporation as a consolidated company, then, in the preliminary organization of the several constituent companies to form and be merged in the new consolidated company, the said Purchasing Committee shall have the right to appoint such associates and cause to be subscribed for and actually paid in cash all such amounts as shall be necessary to complete the valid organization of the said corporation in conformity to the laws of the said several States; and in any event to take all such steps and do such acts, including the selection and qualification of such associates, as they shall be advised by counsel are requisite and necessary to effect a valid organization of the said new corporation.

Fifth. The Purchasing Committee shall have power and authority to convey the franchises and property to be purchased by them as aforesaid to such new company, or, in such appropriate parcels as shall be requisite, to the several constituent companies to be organized by them for the purposes aforesaid, and shall accept and receive
 35 in payment therefor the following amounts and descriptions of the stock and bonds of such new company, that is to say:

First Preferred Stock	\$5,000,000.00
Second Preferred Stock	11,000,000.00
Common Stock	14,000,000.00
First Mortgage Bonds	20,000,000.00

The said First Mortgage Bonds are to be payable in gold coin in fifty years from their date, with interest at the rate of four per cent per annum, payable in like gold coin, semi-annually. A sinking fund of \$100,000 per annum is to be provided for, to be used for the purchase of such bonds at not more than 102 per cent and accrued interest, and the cancellation of the bonds so purchased; but in any year, when, after advertisement, such bonds cannot be purchased for 102 per cent and accrued interest, or in any year when the company shall not have earned at least \$900,000 over operating expenses, such sinking fund shall not be provided; said sinking fund is to be the first fixed charge in each year after payment of the interest on all the outstanding First Mortgage Bonds.

The mortgage securing said bonds shall be in such form and contain such provisions as the Purchasing Committee shall approve, including a provision authorizing the trustee thereunder to enforce the rights of the bondholders by taking possession or by suit after three months default in payment of any semi-annual installment of interest, or in appropriation of sinking fund if earned, and making the principal of all the bonds thereupon immediately due and payable, with interest at the rate of six per centum from the time of such default, and shall convey to the Central Trust Company of New York as trustee, all the property and franchises to be conveyed to the new company as aforesaid, including all the rolling stock and equipment of said Railway Company, and all property and franchises to be thereafter acquired.

The first preferred stock of said new company shall be entitled to a non-cumulative dividend of not more than five per cent per annum, after payment of the fixed charges, the second preferred stock to a non-cumulative dividend of not more than five per cent per annum, after payment of fixed charges and the dividend on said first preferred stock, and the common stock to a non-cumulative dividend of not more than five per cent per annum, after payment of the fixed charges and said dividends on the first and second preferred stock. If there shall be any net earnings remaining in any year after the payments above provided for, they shall be applicable to payment of dividends on all the stock, first preferred, second preferred and common, without discrimination between classes of stock.

36 Neither the first nor second preferred nor common stock shall be increased, except by the concurrent consent of a majority of each of the three classes then outstanding; and no lease of the main line of railway of said new company shall be made without the consent of three-fourths of each of the said three classes of stock.

Sixth. At the time of signing this agreement, the parties of the first and second parts will deposit with the Central Trust Company of New York the securities to the amounts respectively owned by them and the evidence of debt held by them, that is to say:

The holders of First Mortgage Bonds and Second Mortgage Bonds of said Railway Company shall and will deposit their bonds with said Trust Company, and hereby agree to accept in lieu thereof transferable certificates of the said Central Trust Company of New York, in such form as shall be approved by the Purchasing Committee, which certificates shall describe the securities deposited, and provide on their face that the holders thereof shall be entitled to receive all the securities, benefits and advantages provided for in this agreement, pertaining to the securities so deposited hereunder.

The holders of the transferable certificates of the Central Trust Company of New York, heretofore issued and delivered under and in pursuance of the agreement of First Mortgage Bondholders, dated November 21, 1885, assenting to this agreement, shall present their said certificates, representing bonds heretofore deposited with said Trust Company under said last mentioned agreement, and shall accept in lieu thereof certificates signed by said Trust Company, in such form as the Purchasing Committee may adopt and determine upon, or, if the said Purchasing Committee so determine, such old certificates shall be stamped by the Central Trust Company with a suitable device showing the assent of the holder thereof to the terms and provisions of this agreement, and thereafter the holders of such certificates so stamped shall be entitled to participate in the benefits and advantages of the said purchase as in this agreement provided, and the bonds and coupons theretofore deposited by them shall be held and considered as deposited under this agreement and be subject to the terms thereof.

The holders of the stock of the said Railway Company assenting to this agreement, shall present the certificates

representing such stock, and upon the payment of the assessment hereby required, such certificates shall be stamped by the Central Trust Company with a suitable device, showing the date and amount of such payment; or, if the Purchasing Committee so determine, such stock certificates shall be deposited with the Central Trust Company of
37 New York, and certificates shall be issued by said Trust Company in lieu thereof in such form as the Purchasing Committee may adopt; and thereafter the holder of such stock certificates so stamped or such new certificates issued in exchange for stock shall be entitled to participate in all the benefits and advantages of the said purchase as provided in this agreement.

The parties of the second part hereto shall and will at the time of signing this agreement, deposit with said Central Trust Company of New York the evidences of indebtedness of said Railway Company held by them respectively, together with all securities held as collateral thereto, and shall and will execute and deliver to said Trust Company due, proper and sufficient instrument or instruments in writing assigning and transferring to said Purchasing Committee their respective claims and demands against said Railway Company for the purposes of this agreement; and shall accept and receive in consideration thereof a certificate or certificates of said Trust Company in a form to be approved and adopted by the Purchasing Committee, describing the claim and demand so assigned and transferred and the evidence of indebtedness so deposited, and setting forth that the holders of such certificates shall be entitled to receive all the benefits and advantages of this agreement pertaining to claims and demands of that description.

Seventh. The Purchasing Committee shall make due provision for the deposit of all matured and unmatured coupons pertaining to said First and Second Mortgage Bonds, and may fix and determine such penalties or conditions as the interests of the parties may, in their judgment, require for any failure to deposit with the bonds any such matured or unmatured coupons, and shall also have full power, in their discretion, to make equitable provision for any case of lost or destroyed bonds or coupons.

Eighth. The said purchasing committee shall invite, by proper publication, to be determined by them, the holders of all classes of the securities of and claims against said

Railway Company herein provided for, to assent to and become parties to this agreement by depositing their securities and transferring their claims and receiving the certificates above provided for, and shall fix a time within which it may be done, and after the expiration of the time so to be fixed and limited, no holder of any of said securities or claims of any class who shall not, within the time so fixed and limited, have complied with the provisions of this agreement by depositing his securities or transferring his claims, as the case may require, shall have, or be entitled to have any of the rights or privileges herein provided for, nor be entitled in any way to participate in the benefits of this agreement.

38 Provided, however, that the said Purchasing Committee shall have the power in their discretion to extend the time so fixed and limited, but such extension shall be held and construed to apply only to the advantage and benefit of such persons as shall actually deposit their securities or transfer their claims within the time so extended. And provided further, that the said Purchasing Committee shall at any time have the power in their discretion to admit to a participation in the said purchase and the new securities to be issued thereunder, and in the benefits hereof, any security holder or creditor belonging to any or either of the classes entitled to participate in such benefits, upon such just terms and conditions and under such penalties as the Purchasing Committee, shall, in their discretion, see fit to impose; but such action of the said Purchasing Committee shall under no circumstances be taken to confer or establish any right or privilege upon or in favor of any other non-assenting security holder or creditor.

Ninth. All assenting holders of capital stock of said Railway Company shall, at such time or times, and in such manner and installments as may be determined by the Purchasing Committee, pay to the Central Trust Company of New York, for and to the credit of the Purchasing Committee, and subject to its order, an amount equal to ten per centum upon the par value of the stock, whether common or preferred, represented by their certificates which payment shall be noted upon the certificate representing such stock as hereinbefore provided.

Tenth. All the securities and evidences of indebtedness, deposited or transferred under the provisions hereof and all moneys, securities and evidences of indebtedness which may come into the possession or control of the Purchasing Committee under this agreement, shall be subject to the order and control of said Purchasing Committee, and be used by them in carrying out the provisions and purposes of this agreement.

Eleventh. In case it shall be found by the Purchasing Committee to be necessary or expedient for the purpose of completing the purchase of the property and franchises of the said Railway Company to raise money beyond the amount at the time in the hands or under the control of the Purchasing Committee under the provisions hereof, for the purpose of paying in cash the proportion of the bid which may be required by the decree, or under the orders of the Court, or any part thereof, the Purchasing Committee shall be and are hereby authorized to raise and provide such funds, by means of temporary loans for such times and at such rates of interest as the Purchasing Committee shall find to be necessary, and for the purpose of securing the payment of such temporary loans to be raised for the purposes aforesaid, or any of them, the said Purchasing Com-

mittee are hereby authorized and empowered to
39 pledge as security for the moneys so borrowed, all or any part of the securities, stock, evidences of debt, or claims, so deposited or transferred by the parties of the first and second parts, or any of them, and the indebtedness for moneys so borrowed, and the security therefor, shall be evidenced by certificates of the Central Trust Company, with the approval of the Purchasing Committee; and the said depository and the said Purchasing Committee shall have the power to make and execute all such instruments as they shall deem necessary to carry into effect the provisions of this paragraph.

Twelfth. For the purposes mentioned in the Eleventh paragraph hereof, for the repayment of such temporary loans, or to raise money for the payment in cash of the proportionate amount of the bid needed for distribution to the non-assenting security holders or creditors, or for the purchase or payment of claims of non-assenting security holders or creditors of the classes entitled to become parties

hereto; for the payment of the amount of the contribution of non-assenting stockholders, or for any of the purposes of this agreement, where the provisions hereof prove to be deficient, the said Purchasing Committee are hereby authorized to raise moneys by the organization of a syndicate or syndicates, for such purpose or in such other way as the Committee may deem best. The syndicate or syndicates so formed, or other parties furnishing the money under agreement with the Purchasing Committee, shall be entitled to all the rights, privileges and benefits which would have appertained to any such non-assenting security holder, stockholder, or creditor, had he elected to become a party to this agreement.

In case the Purchasing Committee deem it advisable, the stock and other securities which shall be issued and delivered to said Committee by the new company, and which shall not be required for distribution by reason of the failure to assent to the above plan on the part of any stockholders, bondholders or creditors, may be sold by the Committee, either at public or private sales, and at such prices as may seem reasonable to the Committee, and the Committee is authorized to issue temporary certificates representing such new stock or securities, if it deem it advisable to sell such stock or securities before the same are issued.

Thirteenth. The Purchasing Committee are hereby authorized and empowered to negotiate and compound with the holders of claims against the said Railway Company, and to make due provisions for the payment and adjustment of the same, upon such terms as they shall find to be reasonable and proper, to the end that the new company shall be free and clear from the obligations thereof.

40 Fourteenth. All moneys received by the said Purchasing Committee from the contribution to be paid by the stockholders, and all earnings in excess of the operating expenses which shall have accrued from the operation of the railway and which may come into the possession of said Committee, shall be used and disbursed by said Committee for the purpose of making betterments and improvements of the railway and its property, and acquiring rolling stock and equipment; for the settlement or purchase of any claims against or liabilities of the said Railway Company, including any or all Receiver's certificates which may at

any time be issued, and which the Committee may deem it advisable to settle or purchase; for the expenses of the various foreclosure or other suits; for the expenses and compensation of the committee and its agents, counsel and employees; for the purchase of the property of the Railway Company to be acquired by said Committee; for such other payments as may be required under the decree of sale or other orders of the Court in the progress of the suit or suits, which may be necessary for the protection of the interests of the parties hereto; and for the purposes specified in the Fifteenth and Sixteenth paragraphs hereof respectively. The Purchasing Committee is also authorized and directed to assume and pay the expenses and compensation of the parties of the third part.

No money shall be expended, however, for any of the aforesaid purposes by said Purchasing Committee, except on a voucher approved in writing by a majority of the Committee, and after the incorporation and formation of the new company the Purchasing Committee shall pay over any balance of money remaining in their hands and not required for the purpose of carrying out any of the provisions of this agreement, to said new company, under such trusts and conditions, so far as its expenditure by said new company is concerned, as said Purchasing Committee shall determine.

Fifteenth. The said Purchasing Committee is hereby authorized and empowered to make such arrangements for the purchase and acquisition of the title to the rolling stock and equipment embraced in and covered by the existing car trust agreement of said Railway Company as it may deem advisable and prudent, whether for cash or for Receiver's Certificates to be issued under the orders of the Court.

Sixteenth. After the completion of the purchase of the property and franchises of said Railway Company and the organization of the said new company, and the receipt by the Purchasing Committee of the new securities to be received by them in payment for the said property, the said Purchasing Committee shall dispose of such new securities as follows:

41 1. There shall be issued and distributed to the holders of the said certificates to be issued by the Central Trust Company representing the said deposit of

First Mortgage and Second Mortgage Bonds, and to the holders of certificates issued under the Agreement of November 21, 1885, stamped as hereinbefore provided, upon the surrender and cancellation of such certificates, an amount of the new First Mortgage Bonds of said new company, the principal of which shall be equal to one hundred and twelve per cent. of the principal of the old First Mortgage Bonds and one hundred and ten and one-half per cent. of the principal of the old Second Mortgage Bonds; and there shall be paid to such holders, in cash, at the time of the delivery of the new bonds, interest at the rate of four per cent. per annum, on the bonds represented by such surrendered certificates, from December 1, 1886, to the date of such new bonds; and the purchasing Committee shall give such notice, by publication, as it shall deem reasonable, of the time when the new securities will be ready for delivery.

2. To the holders of said certificates of deposit of old Preferred Stock, or of certificates of old Preferred Stock, duly stamped under the provisions of this agreement, an amount of said new First Preferred Stock, equal, par value, to the cash assessment paid in on said old Preferred Stock, and an amount of said new second Preferred Stock equal, par value, to fifty per cent. of the par value of the said old Preferred Stock so deposited or stamped.

3. To the holders of certificates of deposit of old Common Stock, or of certificates of old Common Stock duly stamped under the provisions of this agreement, an amount of said new First Preferred Stock, equal, par value, to the cash assessment paid in on said old Common Stock, and an amount of said new Common Stock, equal, par value, to fifty per cent. of the par value of the said old Common Stock so deposited or stamped.

4. To the holders of claims against said Railway Company of the class represented by the parties of the second part hereto, who shall have deposited their evidences of debt and transferred their claims as in this agreement provided there shall be delivered, upon the surrender of the certificates issued by the depositary therefor, either First Mortgage Bonds of the new company to an amount of principal equal to the amount of the face of such claim and interest, or the Purchasing Committee may, at its option, pay the same in cash.

Any balance of the said new securities not used in the manner above provided, or not disposed of under any of the other articles or paragraphs of this agreement, shall be delivered by the Committee to the new company for the proper uses and purposes of the company.

42 The said Purchasing Committee shall, in the distribution of the said new securities, have power to provide for and make such issues of convertible scrip as shall be necessary to appropriately represent any fractional interest in the said new securities.

Seventeenth. This agreement shall become irrevocable and binding upon all parties thereto and their successors in interest, when and as soon as the holders of three-fourths in amount, par value, of the transferable certificates heretofore issued by the Central Trust Company of New York, under the Agreement of November 21, 1885, and now outstanding; the holders of \$550,000 par value of the second Mortgage Bonds of said Railway Company now outstanding; the holders of a majority in amount, par value, of stock of said Railway Company; and the holders of claims and demands against said Railway Company of the class represented by the parties of the second part, to the amount of \$2,250,000, shall all have assented to this agreement and become parties hereto by making the deposits and payments provided for in the sixth paragraph hereof, as may be evidenced by their acceptance and holding of the certificates to be issued or stamped as provided in said sixth paragraph. As soon as this agreement shall have so become operative and binding, the said parties of the third part shall be entitled to a full release of and from all the duties, obligations and responsibilities imposed upon them by the terms of said Agreement of November 21, 1885; and the said Purchasing Committee is hereby authorized and empowered to make, execute and deliver to said parties of the third part, an instrument of release accordingly, and thereupon said parties of the third part shall be under no further liability or responsibility arising in any manner out of said Agreement of November 21, 1885.

The holders of certificates issued under said agreement of November 21, 1885, who become parties hereto, do hereby severally constitute and appoint the said Purchasing Committee, and any three of them, their attorneys to attend at any general meeting of certificate holders called or held

under the provisions of said Agreement of November 21, 1885, and to vote on their behalf and as their representatives on any question arising at such meeting in the same manner and with like effect as if such holders were personally present.

In the event that the said Purchasing Committee, after making reasonable efforts to carry out the plan contemplated by this agreement, shall not succeed in securing control of the number and amount of securities, stock and claims necessary to render this agreement operative, it shall return all the stock, securities, evidences of debt and instruments of transfer above referred to, to the parties who may have deposited the same, upon the surrender of the certificates of deposit issued here-
43 under, and where the assent to this agreement has been evidenced by stamp upon any certificate issued under the Agreement of November 21, 1885, or any stock certificate, shall upon the presentation thereof cancel such stamp; but in either case, the parties shall first pay their pro rata of the expenses incurred by the Committee, which pro rata shall not exceed one-half of one per cent. of the par value of the stock, securities, and evidences of debt returned, and certificates on which the stamp shall be cancelled as aforesaid. The bonds heretofore deposited under the said agreement of November 21, 1885, shall not, however, be surrendered, but said last-mentioned agreement shall, in the event of the failure of the present agreement to become operative, continue in full force and effect.

Eighteenth. If by reason of legal or other objection any of the provisions of this agreement cannot be strictly performed by said Purchasing Committee, then said Committee shall conform as near as may be to such provisions in the execution of this agreement. The said Committee shall have power to modify the above plan. It shall give notice of any proposed modification by filing a copy thereof with the Central Trust Company of New York, and by advertising the substance thereof in at least three daily newspapers published in the City of New York, at least twice a week and during two weeks, and such advertisement shall be considered to have the full effect of personal notice. All parties of the first and second parts who do not express in writing their dissent from such modification, and deliver such written dissent to said Trust Company within two

weeks from the date of the last publication, shall be considered to have assented to such modification. The parties of the first and second parts who may express such dissent, shall be entitled to the return of the stock, bonds or evidences of debt which they may have deposited, and contributions which they may have paid, upon the surrender of their certificates issued hereunder, or the cancellation of the stamp indicating assent to this agreement, and on payment of their pro rata of expense incurred up to the date of the return or cancellation, which shall not exceed one-half of one per cent. of the par value of such stock, securities, or evidences of debt.

Nineteenth. The Purchasing Committee shall have the sole power to construe this agreement, and its construction thereof shall be final. It is the intent of the parties of the first and second parts to give to the Committee full and absolute control, and all powers necessary or proper for the exercise of such control of the reorganization of said Railway Company, and all powers requisite, or in the opinion of the Committee desirable to accomplish such reorganization are hereby conferred upon it in addition to those specially enumerated. The Committee, however, shall have no power or right to obligate any of the subscribers to or for the payment of any sums of money other than those provided for in this agreement.

44 Any member of the said Purchasing Committee may at any time resign by giving notice in writing to the other members, and the Committee may settle all transactions with a member who shall cease to be such, and with the representatives of a deceased member, and may give a complete release and discharge. The Committee may appoint counsel, agents and servants, and fix the compensation for their services. The members of the Committee shall also be entitled to a fair compensation for their own services, provided that the plan herein provided for, or any part thereof, be executed. It is agreed that the present or future members of the Committee may be or become pecuniarily interested in any of the property or matters which are the subject of this agreement. It is expressly understood that the Committee assumes no responsibility for the execution of the above plan or any part thereof; its members, however, will in good faith endeavor to execute the same.

Twentieth. The said Purchasing Committee shall keep a record of its proceedings. No member shall be liable for the misconduct, omission or fault of any other member, nor for his own, except in case of willful neglect of malfeasance; nor for the misconduct of any agent or employee of the Committee. The Committee may delegate any necessary authority or discretion to any sub-committee or agent.

Twenty-First. The Purchasing Committee shall be entitled at any time to a settlement and discharge in respect to prior action. Richard King, President of the National Bank of Commerce, W. E. Corlies, Vice-President of the Bank of America, and George F. Baker, President of the First National Bank of New York, are hereby constituted the irrevocable representatives of the parties of the first and second parts, for the purpose and with full authority to fix the compensation of the members of the Purchasing Committee, and to pass upon, and to finally adjust its accounts and thereupon to give its members a full discharge. Either of such representatives may resign by giving notice in writing to the others and to the members of the Purchasing Committee. In the event of the death, resignation or refusal to act, or removal of either of such representatives, those who remain may, in writing, appoint successors, so as at all times to keep the number up to three, upon giving a written notice to the members of the Committee; the action of any two of such representatives shall have the same effect as would the action of the entire number.

Twenty-Second. This agreement shall be printed, and copies thereof may be signed; all of said copies so signed shall be deemed and taken as constituting one original paper. The deposit of securities, stock or claims and the receipt of certificates issued therefor, or the stamping of certificates as herein provided, shall have the same effect as if the holder of such certificates had actually subscribed this agreement.

45 In witness whereof the said parties have hereunto set their names, or affixed their corporate seals, and have written opposite their respective names or seals the amount of the bonds, stock or claims held by them, and the classification of such securities and claim.

The Railway Company failed to make the payment to the Clerk of the Court in ten days as directed by the aforesaid

decree, and on April 14, 1887, the Court of Common Pleas ordered the Special Master Commissioner to carry out the order of sale. Accordingly, on May 19, 1887, the properties of the Railway Company were sold by the Special Master Commissioner in accordance with the Court's decree for the sum of \$16,000,000 to the purchasing committee named in the agreement of February 4, 1887. The purchasing committee paid \$100,000.00 in cash to the Special Master Commissioner and elected to pay the balance of the purchase price by paying over and surrendering certain indebtedness of the receiver and the first mortgage bonds of the Railway Company as permitted by the order of the Court.

On May 21, 1887, the Court of Common Pleas ratified, approved, and confirmed the sale of the Railway Company's properties. It further ordered that upon the payment of the balance of the purchase price the Special Master Commissioner should execute a deed conveying the properties of the Railway Company to the purchasing committee. The Special Master Commissioner was also ordered to cancel receiver's certificates of indebtedness which should be received on account of the balance of the purchase price and also to stamp upon the bonds and coupons paid over and surrendered to him by the purchasing committee the amount or percentage of their par value at which so taken, and to thereupon return the same to the purchasing committee to be held by them solely for the portion thereof not paid through the sale and purchase of the Railway Company's properties.

46 On July 2, 1887, the purchasing committee by deeds conveyed to The Ft. Wayne & Illinois Railroad Company the properties of the Railway Company purchased which were located in the State of Indiana, for the sum of \$14,350,000.00; to The Chicago & State Line Railroad Company the properties of the Railway Company located in the State of Illinois for the sum of \$1,500,000.00; to Daniel W. Caldwell, Jephtha H. Wade, George A. Garretson, John C. Hale, and Harvey H. Brown the properties of the Railway Company located in the State of Ohio for the sum of \$23,550,000; to The Erie and State Line Railroad Company the properties of the Railway Company located in the State of Pennsylvania for the sum of \$4,800,000.00; and to The New York, Chicago & St. Louis Railroad Company the properties of the Railway Com-

pany located in the State of New York for the sum of \$7,300,000.00.

The Fort Wayne & Illinois Railroad Company was organized under the laws of the State of Indiana by the purchasing committee and their associates on June 27, 1887, for the purpose of maintaining and operating the properties of the Railway Company located in that state. The Chicago & State Line Railroad Company was organized under the laws of the State of Illinois by the purchasing committee on June 16, 1887, for the purpose of acquiring the properties of the Railway Company located in that state. The Cleveland & State Line Railroad Company was organized under the laws of the State of Ohio on August 13, 1887, by the aforesaid D. W. Caldwell, J. H. Wade, G. A. Garretson, J. C. Hale, and H. H. Brown for the purpose of acquiring the properties of the Railway Company purchased by them from the purchasing committee. The Erie & State Line Railroad Company was caused to be organized under the laws of the State of Pennsylvania by the purchasing committee on June 24, 1887, for the purpose
47 of maintaining and operating the properties of the Railway Company located in the State of Pennsylvania; and The New York, Chicago & St. Louis Railroad Company was organized on June 16, 1887, by the purchasing committee and their associates for the purpose of acquiring the properties of the Railway Company located in the State of New York.

The purchase price of \$14,350,000.00 was paid by The Ft. Wayne and Illinois Railroad Company by promissory notes drawn to the order of F. P. Olcott, Chairman of the purchasing committee. The Chicago & State Line Railroad Company gave a promissory note for the purchase price of the properties acquired by it in the sum of \$1,500,000.00. For the properties acquired by The Cleveland & State Line Railroad Company its entire capital stock, preferred and common, of a par value of \$13,950,000 was issued to the purchasing committee and a promissory note in the sum of \$9,600,000.00 was given for the balance. The Erie & State Line Railroad Company issued promissory notes to the purchasing committee in the sum of \$4,800,000.00 in payment of the purchase price of the properties acquired by it. The New York, Chicago & St. Louis Railroad Company gave promissory notes to F. P. Olcott, chairman of the purchas-

ing committee, for the entire purchase price of the properties acquired by it in the sum of \$7,300,000.00.

On July 7, 1887, a joint agreement was entered into between the aforesaid The New York, Chicago & St. Louis Railroad Company and The Erie & State Line Railroad Company, whereby it was agreed to consolidate the said corporations into a corporation to be known as The New York, Chicago & St. Louis Railroad Company pursuant to the laws of New York and Pennsylvania. This consolidation was duly effected pursuant to the statutes of the respective states of New York and Pennsylvania on August 15, 1887.

48 On August 18, 1887, a joint agreement was entered into by and between the aforesaid consolidated The New York, Chicago & St. Louis Railroad Company, The Cleveland & State Line Railroad Company, and The Ft. Wayne & Illinois Railroad Company, whereby it was agreed to consolidate the aforesaid corporations into a corporation to be known as The New York, Chicago & St. Louis Railroad Company, pursuant to the statutes of the respective states of New York, Pennsylvania, Ohio, and Indiana. This consolidation was duly effected in accordance with the laws of the various states on September 27, 1887.

The authorized capital stock of the consolidated The New York, Chicago & St. Louis Railroad Company (the petitioner) consisted of three hundred thousand shares having a par value of \$30,000,000.00. Of this \$5,000,000.00 was first preferred, \$11,000,000.00 second preferred, and \$14,000,000.00 common. The entire capital stock was exchanged par for par for the capital stock of the underlying corporations and was issued to the purchasing committee who held the capital stock of the said underlying corporations. This capital stock was then disposed of by the purchasing committee as shown in its final report as follows:

First Preferred.

Received by the Reorganization Committee:

50,000 shares	\$5,000,000.00
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Delivered by the Committee, viz:

To holders of old common stock
who have paid assessment of
\$10 per share

to Nov. 12th, 1902.....	278,667 shrs.	\$2,783,800.00
to July 1st, 1908.....	1,126 "	10,900.00

To be reserved for 30 shares old
Common Stock assessment
paid but not yet surrendered
for new stock.....

30 "	300.00
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49

For old stock outstanding no
assessment paid

177 shrs.	1,770.00
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280,000 "	
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To holders of old Preferred
Stock who have paid assess-
ment of \$10 per share

to Nov. 12th, 1892.....	219,587 "	2,195,200.00
to July 1st, 1908.....	410 "	4,100.00

Outstanding stock assessment
unpaid

3 "	30.00
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220,000 "	
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Due Central Trust Co.....
1 share sold

38 "	
1 "	

3,900.00

\$5,000,000.00

Second Preferred.

Received by Reorganization Committee, 110,-
000 shares

\$11,000,000

Delivered by Committee, viz:

To holders of old preferred stock
assessment \$10 per share paid

to Nov. 12th, 1892.....	219,587 shs.	\$10,978,700
to July 1st, 1908.....	410 "	20,500

Due on old stock outstanding no
assessment paid

3 "	150
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220,000 "	
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Due Central Trust Company...

6½ "	
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650

\$11,000,000

Common.

Received by the Reorganization Committee,
140,000 shrs. \$14,000,000

Delivered by Reorganization Committee, viz:

To holders of old Common Stock
who paid assessment of \$10
per share

to Nov. 12th, 1892, amount-			
ing to	278,667	shs.	\$13,930,700
to July 1st, 1908, amount-			
ing to	1,126	"	56,200

50

Assessment paid by the follow-
ing named holders of Common
Stock of the old Company
who have not yet surrendered
their certificates for stock of
the new Company, viz:

No. 872 name Jose-
phine M. Parsons 10 shs.

No. 630 name Geo.

Sturges 15 shs.

No. 349 name A. J.

Trunky 5 shs.

To be reserved.....	30	"	1,500
Due on old stock on which no assessment has been paid out- standing	177	"	8,850
	280,000	"	
Due Central Trust Company...	25½	"	
Shares sold	2	"	
	27½	"	2,750
			\$14,000,000

On September 1, 1887, the properties of The Chicago & State Line Railroad Company were leased in perpetuity to

The Ft. Wayne & Illinois Railroad Company. The lease provided that the lessee should have full right and power to merge and consolidate its properties with those of any other corporation or corporations pursuant to law and that in such event all right, title, and interest vesting in it under the lease should vest in such consolidated corporation.

When the properties of the aforesaid underlying corporations were taken over by the consolidated corporation, The New York, Chicago & St. Louis Railroad Company (the petitioner in this proceeding), they were indebted to the purchasing committee in the aggregate sum of \$20,000,000.00, such sum being a part of the purchase prices of their several lines of railway and other property, the balance of such purchase prices having previously been paid by the issuance of such corporations' capital stock. The New York, Chicago & St. Louis Railroad Company became liable for the payment of this indebtedness, and in order to meet

its obligations thereon its board of directors by resolution duly adopted September 28, 1887, authorized the issue of its First Mortgage 4% Coupon Gold Bonds dated October 1, 1887, maturing in 50 years in the par value of \$20,000,000.00 to be delivered to the purchasing committee in payment of the said indebtedness. This action of the board of directors was duly approved by the stockholders at a meeting held on the same date. The bonds were thereupon delivered to the purchasing committee in satisfaction and payment of the indebtedness. On October 31, 1887, the bonds were set up on the corporation's books by a charge to cost of road and equipment in the full par value thereof of \$20,000,000.00.

The purchasing committee disposed of the aforesaid bonds as follows:

To holders of old First Mortgage Bonds of the Railway Company in the par value of \$15,000,000 at \$1,120.00 per bond.....	\$16,800,000
To holders of old Second Mortgage Bonds of the Railway Company of a par value of \$1,046,000 at \$1,105.00 per bond.....	1,155,830
Delivered to and for the use of the new company	2,044,000
Surplus under the plan of reorganization to the new company	170
Total	<u>\$20,000,000</u>

The petitioner claims that it should be permitted to set up as discount on its first Mortgage 4% Coupon Gold Bonds the difference between the par value of \$17,955,830.00 which were issued by the purchasing committee to the holders of Railway Company first and Second Mortgage Bonds in the par value of \$16,046,000.00, and the said par value of \$16,046,000, or a total discount of \$1,909,830.00, and amortize this amount over the life of the bonds. On the basis of a 50-year life the aliquot portion of the total discount applicable to each year is \$38,196.60. Since \$116,000 par value of the bonds outstanding on December 31, 1916, were retired during the year 1917, the amount claimed as a deduction from gross income for said year is \$35,045.38. The respondent has refused to allow any deduction for amortization of discount on the ground that no discount was sustained by the petitioner upon the issue of its aforesaid bonds to the purchasing committee.

5. During the year 1917 petitioner purchased for retirement its aforesaid First Mortgage Bonds amounting to \$116,000.00 par value at a cost of \$99,041.66, the difference between par value (\$116,000) and the price at which they were purchased by petitioner (\$99,041.66) amounts to \$16,958.34, which respondent has included in taxable net income.

6. By ordinance No. 33723 passed by the City of Cleveland, Ohio, the petitioner was required to eliminate certain grade crossings located in that City. On August 21, 1914, the president of the petitioner, by letter, accepted on behalf of the corporation the terms of the aforesaid ordinance. In connection with the elimination of said crossings certain properties were acquired the cost of which was borne under the terms of the ordinance, 35 per cent by the City of Cleveland, and 65 per cent by the petitioner.

During the years 1914, 1915 and 1916 the petitioner received rentals from various tenants of property which had been acquired in connection with the grade elimination project. Said rentals amounted to \$26,862.29, \$9,786.09, and \$5,090.46, respectively. Because of uncertainty as to whether or not the City of Cleveland was to share in the rentals collected, these amounts were currently credited on the petitioner's books to a suspense account and remained in said account until December, 1917, at which time the entire amount, aggregating \$41,738.84, was trans-

53 referred to petitioner's profit and loss account and reported as taxable income in its return for the year 1917. An entry was made by petitioner in December, 1923, debiting profit and loss account and crediting investment account in said amount. The respondent has refused to eliminate from taxable income, for the year 1917, the amount in question.

7. Omitted because it relates to a question no longer in issue.

Opinion.

STERNHAGEN: 1. The petitioner claims a deduction of \$35,045.38 in 1917 as discount accrued in that year upon its first mortgage 4 per cent fifty-year bonds issued in 1887. The only question raised is whether there actually was any discount involved in the issuance of petitioner's bonds; for respondent concedes that if there was discount in 1887, when the bonds were issued, its amortization may be recognized and an aliquot part thereof, admittedly \$35,045.38, deducted. *Chicago, Rock Island & Pacific Railway Co.*, 13 B. T. A. 988; *Kansas City Southern Railway Co.*, 16 B. T. A. 665; *Terminal Railroad Association of St. Louis*, 17 B. T. A. 1135.

The petitioner was organized in 1887 as the result of a compulsory reorganization of the ownership and financial structure of the railroad properties. Being newly organized and incorporated, there can be no question as to its separate legal existence, distinct from the old Railway Company. We may, for our present purpose, disregard the several intermediate local corporations and, without inquiry, treat them as if the petitioner stood in their shoes. The old Railway Company, being in default upon the interest obligation of its first and second mortgage bonds, was

54 required to submit to a sale of its properties and to bring about a discharge of the said bonded indebtedness. It does not appear when these old bonds were issued; what were the terms of their issuance, that is, whether they were sold for cash at par, a discount or a premium or issued for property or as refunding bonds; whether they had matured or were about to mature; how they had been treated on the accounts, or whether amortization in respect of them had been an adopted practice. It

appears only that they were outstanding; that interest was in default, and that \$16,046,000 par value thereof were turned in by the holders and discharged. There was no assumption by the petitioner of the old liability. From the default had sprung the remedy of discharge and the court had required that such remedy be enforced. Whatever may have been the terms of the old bonds, the financial means for performing them, or the method of accounting in respect of them, they necessarily came to an end with the discharge of the bonds. While to the bondholder it may perhaps have been of little practical moment whether there was a continuation of the old debt or a substitution of a new, this does not serve to wash out the legal steps and results which it required all of the machinery of the law to bring about.

The situation is, in this respect, quite different from that in *Western Maryland Railway Company v. Commissioner*, 33 Fed. (2d) 695, cited by petitioner, where the reorganization successor assumed the predecessor's obligation of the old bonds and the court held that in the detail circumstances the tax deduction for amortization ran with the obligation despite the substitution of the new obligor. Because the discounted bonds carried through the reorganization, it was held that the effect of the discount went with it. Whether the court was right or wrong in the weight and effect to be given to the reorganization and in its selection of the features to be emphasized (see *Missouri Pacific Railroad Co.*, 22 B. T. A. 267), the scope of the decision is not broad enough to comprehend a situation like this, where so far as appears, the original bonds were not sold at a discount, no amortization was accounted for or remained unaccounted for, and new bonds of the company were issued when the old were discharged. Unlike the *Western Maryland*, this petitioner is not seeking to deduct the remaining amortization of any discount on the original bonds, but claims to amortize ratably the excess (\$1,909,830) of par value (\$17,955,830) of its own bonds over the par value (\$16,046,000) of the old bonds discharged. If it is to succeed, therefore, it can not be by virtue of the *Western Maryland* decision, upon which it almost wholly relies, but by virtue of a wider reason which neither that court nor any other has announced.

The amortization of discount and premium upon the issuance and sale of bonds has in various aspects been considered.* However elaborately we might now analyze it, since the amortization of discount has been openly recognized by the Treasury Department and sustained by this Board, and since it is not controverted here, we need only consider whether the facts of the present case are within the rule.

When we speak of discount, in the present connection, it is important that we think of substance and not let
56 the word itself run away with us. The recognition of amortization of discount is justified, not by the use of the word discount, but by the circumstances of the original issue to which the word is applied. It would be begging the question to assume from the fact of amortization the existence of discount, because the question for decision is the propriety of the amortization. We must settle the major premise that this is discount before we can apply the minor that its amortization is deductible, to complete the syllogism.

Discount is a variable term, but the meaning which is clearly intended in this connection is, the difference between the face amount of the debt which, it is assumed, will be paid at maturity, and the actual lower amount which is received from the lender at the time of the creation of the debt. Colloquially, it is the difference between the face amount of the bonds and the lower cash sale price. The amortization of this discount imports a theory that the discount is an adjustment of the difference between the interest prescribed and the going market rate for money. It is sometimes metaphorically called deferred interest. To a taxpayer on the cash basis, amortization is not deductible, *Chicago & Alton R. R. Co. v. United States*, 53 Ct. Cl. 41; *Baldwin Locomotive Works v. McCoach*, 215 Fed. 967, 221 Fed. 59, because whether this quasi-interest be treated as if paid at the time of the issuance of the bonds

**Baldwin Locomotive Works v. McCoach*, 215 Fed. 967; 221 Fed. 59.

Chicago & Alton R. R. Co. v. United States, 53 Ct. Cl. 41.

New York Life Insurance Co. v. Edwards, 3 Fed. (2d) 280; 8 Fed. (2d) 851; 271 U. S. 109.

Commissioner v. Old Colony R. R. Co., 26 Fed. (2d) 408, affirming 6 B. T. A. 1025.

Corn Exchange Bank, 6 B. T. A. 158.

Chicago, Rock Island & Pacific Railway Co., 13 B. T. A. 988, 1027.

Missouri Pacific R. R. Co., 22 B. T. A. 267.

or at the time of their maturity, there is no room for a non-cash deduction at any other time when no actual disbursement takes place. On the accrual basis, the theory being that the discount is quasi-interest on a loan, it is treated as if accruing ratably year by year in enlargement of the actual interest expressed in terms in the bond. It

seems plain, therefore, that this amortization is but
57 a concept devised for accounting convenience and is limited by the resemblance to interest. Were the discount regarded as a variation in the amount of the principal of the loan either at the time it was made or at the time of repayment, it may be questioned whether even an accrual system could recognize it at intermediate times. It is only as quasi-interest that its amortization is given deductibility.

The respondent argues that the \$17,955,830 bonded obligation was part of the purchase price assumed for the railroad properties; and that irrespective of the actual value of the properties acquired, their purchase price is not deductible whether by a process of amortization or otherwise. This is but another way of saying that the characteristics of the interest theory of discount are entirely absent and invoking affirmatively the more particular doctrine of non-deductibility of cost of property until its realization through sale or other disposition.

We see nothing in the stipulated facts to indicate discount. The bond issue may, for all that appears, have been no greater in face amount than the value of the property would justify as principal. The fact that the bonds were issued to the former bondholders by agreement in proportion to their holdings of old bonds does not, as to the issuer, amount to an exchange, since the old bonds were discharged and not acquired; nor does it establish any reason for treating part of the face amount as quasi-interest. There was nothing above 4 per cent by way of compensation for the use of money; and, in any event, the going rate is not in evidence. There was no cash received and no loan made. There was only an acquisition of encumbered property and a promise to pay for it.

58 The petitioner says that "the effect is the same as if the petitioner had sold \$17,955,830 of its first mortgage bonds for cash of \$16,046,000 and with such proceeds paid off the old bonds. Had this been done there would be

no doubt that petitioner had sustained a discount of \$1,909,830. The same purpose has been accomplished by refunding the bonds and disposing of the old obligations in that manner just as effectively as had the old bonds been redeemed for cash." But in the decision of the case, the facts and their legal significance are more important than the similarity between their practical effect and that of a hypothetical situation. *United States v. Phellis*, 257 U. S. 156; *Anna M. Harkness*, 1 B. T. A. 127; *Gladys Bilicke*, 20 B. T. A. 784; *Chandler Shipbuilding Co.*, 22 B. T. A. 132. The clear intendment of the decree and the agreement was a sale of the property and a discharge of the old bonds, and this was carried out in fact and in law. This carried with it numerous incidents, and in the absence of fraud or other overwhelming reason, the legal significance of this deliberate conduct may not be brushed aside to afford relief from the onerous incident of income tax. *Edward A. Langenbach*, 2 B. T. A. 777.

We are of opinion that, accepting as we do for the purpose of this case the propriety of deducting amortization of discount in a proper case, the evidence does not establish such discount; and we therefore sustain the respondent in his disallowance of the deduction claimed on that account.

2. Out of the total issue of the aforesaid first mortgage bonds, the petitioner in 1917 purchased for retirement bonds having a face obligation of \$116,000 and paid therefor \$99,041.66. Reverting to what we have already said as to the origin of these bonds, it will be seen that \$116,000 was part of the purchase price which the petitioner assumed to pay for the railroad property. Now, however, it is
59 enabled to discharge this much of the purchase price for \$99,041.66. The respondent calls the difference of \$16,958.34 a gain. So far as this Board is concerned, the question is settled by numerous decisions that no gain results under such circumstances. *Independent Brewing Co.*, 4 B. T. A. 870; *New Orleans, Texas & Mexico Ry. Co.*, 6 B. T. A. 436; *National Sugar Mfg. Co.*, 7 B. T. A. 577; *Houghton & Dutton Building Trust*, 20 B. T. A. 591. Respondent's determination on this point is reversed.

In considering this point, we have assumed the soundness of our decision on the previous point as to amortization. If, however, our view on that point be not sustained, further consideration would be required of the present issue. For

it may be doubted whether, after enjoying deductions of amortization predicated upon a promise to pay par, a taxpayer who pays less and thus belies the hypothesis upon which its deductions have been founded may say no gain has been realized. Cf. *John F. Campbell*, 15 B. T. A. 458 (now on review, Ct. App. District of Columbia).

3. In 1914, 1915, and 1916, petitioner received \$41,738.84 rental for properties acquired in the crossing elimination. Beyond the petitioner's own uncertainty about a possible claim of the city, there is nothing in the evidence to cast doubt on petitioner's ownership of the rent when it was received. The bookkeeping credit to suspense account when received and subsequent inclusion in income of 1917 does not change the fact of receipt. Nor does petitioner's mere doubt of its ownership. As rent it was received apparently contemporaneously with the tenant's occupancy, and there is no problem of accrual. From the evidence, we find that

60 no part of the \$41,738.84 was income of 1917 and the respondent is reversed. *Cleveland Railway Co. v. Commissioner*, 36 Fed. (2d) 347, affirming 10 B. T. A. 310; *Jacob F. Brown*, 18 B. T. A. 859; *Brooklyn Union Gas Co.*, 22 B. T. A. 507; cf. *Lucas v. American Code Co., Inc.*, 280 U. S. 445.

Reviewed by the Board.

Judgment will be entered under Rule 50.

Smith, Arundell, and McMahon concur in the result only.

TRAMMELL, dissenting: Even conceding that assets were acquired or paid in for bonds, in my opinion, it does not necessarily follow that the bonds were not issued at a discount. Clearly, if the owner of the property had agreed to take the bonds for the property at a discount we could not say that there was no discount and it would have been amortizable, but instead of agreeing specifically to receive the bonds at a discount, the question is, Did not what actually occurred amount to the same thing? In other words, were not the bonds actually taken at a discount? I think so. What actually occurred, it seems, was that the bonds were issued and taken at less than their face value. I do not consider that it is important that property was received instead of cash. If the owner of the properties had said that they would give their property for the bonds at a discount of a certain per cent, the case would be clear. Instead of doing

so, it was agreed to give bonds for property worth less, the same result as if cash less than the face of the bonds had been received. I see no reason why discount on bonds is limited to borrowed money. If a person had property to sell and agreed to take \$9,500 cash for it or \$10,000 par value of bonds to be issued and taken at 95, it seems to me that if the bonds were taken it could not be said that there was no discount on the bonds simply because property was acquired instead of cash borrowed. As said in the prevailing opinion, we should not let the word "discount" run away with us, but should consider the facts in the present case.

61 United States Board of Tax Appeals, Washington.

Docket No. 21047.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Judgment.

Subsequent to the Board's report of May 13, 1931, 23 B. T. A. 177, respondent filed a proposed judgment which the petitioner agrees in writing is in conformity with the said report. In accordance therewith, it is

Ordered, adjudged and decided that there is an overpayment of income tax for 1917 of \$1,462.83.

Enter.

(Signed)

JOHN M. STERNHAGEN,

Member.

Entered Aug. 18, 1931.

A true copy. Teste:

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,

Clerk U. S. Board of Tax Appeals.

62 ——— Nov. 30, 1931. U. S. Board of Tax Appeals.

United States Board of Tax Appeals. Filed Nov. 30, 1931.

United States Board of Tax Appeals.

Docket No. 21047.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Motion.

Comes now the Commissioner of Internal Revenue, through his attorney C. M. Charest, General Counsel, Bureau of Internal Revenue, and moves that the Board reopen the above entitled case and set aside its final order therein which was entered on August 18, 1931, for the purpose of reconsidering its decision promulgated May 13, 1931, with respect to the issue involving the question of whether or not the corporation realized taxable gain through the purchase of certain of its outstanding bonds for less than their face value in view of the decision of the Supreme Court on November 2, 1931, in the case of United States v. Kirby Lumber Company, 52 Sup. Ct. Rep. 4.

(Signed)

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

E. C. ALGIRE,
Special Attorney,
Bureau of Internal Revenue.

ECA:RBI.

Granted Dec. 7, 1931.

(Signed)

JOHN M. STERNHAGEN,
U. S. Board of Tax Appeals.

66 United States Board of Tax Appeals. Filed Jan.
27, 1932.

United States Board of Tax Appeals.

Docket No. 21047.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD Co.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Stipulation with Respect to Review of Board's Decision.

Pursuant to the provisions of Section 1002 (d) of the Revenue Act of 1926, it is hereby stipulated and agreed between the parties to the above-mentioned cause, by their respective attorneys, that the decision of the Board therein may be reviewed by the Court of Appeals of the District of Columbia.

ADRIAN C. HUMPHREYS,

Attorney for the Petitioner.

C. M. CHAREST,

*General Counsel, Bureau of Internal
Revenue, Attorney for the Re-
spondent.*

67 United States Board of Tax Appeals. Filed Feb.
4, 1932.

In the Court of Appeals of the District of Columbia.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition for Review.

To the Honorable the Chief Justice and Associate Justices
of the Court of Appeals of the District of Columbia:

Your petitioner being aggrieved by a decision of the United States Board of Tax Appeals, respectfully submits this petition for review and shows:

I. This is a proceeding to review a decision of the United States Board of Tax Appeals (23 B. T. A. 177) and orders and judgments entered redetermining the income tax liability of the petitioner for the year 1917.

II. Pursuant to Section 1002 (d) of the Revenue Act of 1926, the parties have agreed that the review shall be in this Court and a stipulation to that effect was filed with the Clerk of the Board of Tax Appeals.

68 III. The nature of the controversy is the determination of the amount of income tax payable by the petitioner for the year 1917, under the provisions of the Revenue Act of 1916 (39 Stat. 756, c. 463) as amended by the Revenue Act of 1917 (40 Stat. 300, c. 63).

IV. The following questions are involved:

(1) Whether, incident to the issuance by the petitioner of its First Mortgage 4% Coupon Gold Bonds, there was a discount the amount of which is amortizable over the life of the bonds.

(2) The amount of taxable income, if any, upon the purchase for retirement by petitioner during the year 1917 of certain of its First Mortgage 4% Coupon Gold Bonds.

V. This case was heard by the Board on October 30, 1930, on the pleadings and a stipulation of facts. On May 13, 1931 the Board rendered its decision finding for the respondent on the first issue and for the petitioner on the second issue. On August 18, 1931 the Board entered its order and judgment determining an overpayment of income tax by the petitioner for the year 1917 in the sum of \$1,462.83. On November 30, 1931 respondent moved to set aside and vacate the order entered August 18, 1931 as to the second issue in view of the decision in *Kirby Lumber*

69 *Co. v. United States*, 284 U. S. 1. The motion was granted December 7, 1931. On January 19, 1932 a consent was filed by the petitioner to a modification of the Board's decision and judgment, the consent reserving the right to a redetermination of the amount of profit resulting from the purchase for retirement in the event of a final decision that there was a discount incident to the issuance of said First Mortgage 4% Coupon Gold Bonds in 1887. On January 19, 1932, the Board entered a new judgment determining an overpayment of income tax by the petitioner for the year 1917 in the sum of \$445.33.

VI. The facts were stipulated before the Board and may be summarized as follows:

A Plan of Reorganization was entered into on February 4, 1887 by and between the holders of First and Second Mortgage Bonds, holders of Capital Stock Preferred and Common, and sundry creditors of the New York, Chicago & St. Louis Railway Company (sometimes referred to hereinafter as Railway Company), and a Purchasing Committee designated and appointed by the said bondholders, stockholders and creditors.

Pursuant to said Plan of Reorganization the Purchasing Committee secured the deposit of the required percentage of bonds and stock of the Railway Company and declared the Plan operative. Under said Plan the Purchasing Committee was authorized to secure a sale of the properties of the Railway Company and to organize a company or
70 companies for the purpose of taking over the railway properties, rights and franchises, in exchange for which the Purchasing Committee was to receive a stipulated amount, par value, of Capital Stock, Preferred and Common, and bonds of the new company or companies. These securities were in turn to be disposed of by the Purchasing Committee to the assenting stockholders and bondholders on the basis stipulated in the Plan.

All of the steps provided in the Plan of Reorganization were carried out meticulously. Under order of Court there was a sale as an entirety without appraisal of the Railway Company's properties to the Purchasing Committee. The Purchasing Committee then organized separate corporations in each of the states in which the properties were located, following which it consolidated the constituent companies into the petitioner and received from the petitioner First and Second Preferred Stock and also Common Stock of an aggregate total par value of \$30,000,000 and First Mortgage 4% Coupon Gold Bonds of an aggregate par value of \$20,000,000.

Out of the total of said First Mortgage 4% Coupon Gold Bonds, \$16,800,000 par value were disposed of by the Purchasing Committee to former holders of the First Mortgage Bonds of the Railway Company who had deposited a total of \$15,000,000 par value of said Railway Company bonds on the basis of \$1,120.00 per value for each \$1,000.00 par value bond deposited.

71 Out of the total of said First Mortgage 4% Coupon Gold Bonds \$1,155,830.00 par value were disposed of to former holders of old Second Mortgage Bonds of the Railway Company, who had deposited a total par value of \$1,046,000.00, on the basis of \$1,105.00 par value for each \$1,000.00 bond deposited. The remaining portion of the \$20,000,000 par value First Mortgage Bonds were delivered to and for the use of the new company.

Petitioner avers that the aggregate of \$17,955,830.00 par value First Mortgage 4% Coupon Gold Bonds were issued by the petitioner to refund bonds of the Railway Company aggregating \$16,046,000.00 par value, and that the excess of the liability represented by the par value of the said First Mortgage Bonds issued over the par value of the said bonds thereby refunded and canceled (the difference amounting to \$1,909,830), is discount incident to the issuance of said First Mortgage 4% Coupon Gold Bonds.

If the above difference of \$1,909,830.00 is discount the petitioner is entitled to a deduction from gross income for the year 1917 on this item of \$35,045.58 as stipulated and found by the Board.

The second issue depends entirely upon the first issue. If the decision of the Board of Tax Appeals is sustained on the first issue, the amount of the profit resulting from the retirement in 1917 of \$116,000 par value of said

72 First Mortgage Bonds at a cost of \$99,041.66 was properly determined by the Board at \$16,958.34.

If, on the other hand, it is held that there was a discount incident to the issuance of petitioner's First Mortgage Bonds, the amount of the profit resulting from said retirement will be less than found by the Board to the extent of any unamortized discount on said bonds at the date of purchase.

VII. The petitioner, as the basis for review by this Court, makes the following assignment of errors:

(1) The Board erred in holding that the separate steps taken in pursuance of the Plan or Reorganization were controlling rather than the object and execution of the Plan as a whole.

(2) The Board erred in ruling that the form of the reorganization rather than the substance was controlling.

(3) The Board erred in holding, contrary to the stipulated facts, that "The petitioner was organized in 1887 as

the result of a compulsory reorganization of the ownership and financial structure of the railroad properties.”

(4) The Board erred in holding that petitioner's First Mortgage 4% Coupon Gold Bonds were issued in part payment of the railroad properties.

(5) The Board erred in failing and refusing to hold that petitioner issued its First Mortgage 4% Coupon Gold Bonds in 1887 at a discount.

73 (6) The Board erred in failing and refusing to reduce the amount of profit resulting from the purchase by the petitioner in 1917 of certain of its First Mortgage 4% Coupon Gold Bonds by the amount of unamortized discount on said bonds at the date of purchase.

(7) The Board erred in not entering judgment for the petitioner in a greater amount as an overpayment of income taxes for the year 1917.

Wherefore petitioner prays that the decision of the Board of Tax Appeals entered herein be reviewed and revised by this Honorable Court, and for such other further and general relief as may to this Court seem just and proper in the premises.

THE NEW YORK, CHICAGO & ST.
LOUIS RAILROAD CO.,
By ADRIAN C. HUMPHREYS,
NEWTON K. FOX,
Attorneys.

74 United States Board of Tax Appeals. Filed Feb.
4, 1932.

United States Board of Tax Appeals.

Docket No. 21047.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

To the General Counsel, Bureau of Internal Revenue:

Please take notice that we have filed in the office of the Clerk of the United States Board of Tax Appeals on

February 4, 1932, the original and one copy of a petition for review of the above-entitled case by the Court of Appeals of the District of Columbia.

A copy of said petition is served on you herewith.

ADRIAN C. HUMPHREYS,
NEWTON K. FOX,
Attorneys for Petitioner.

Service of a copy of the above-mentioned petition for review is hereby acknowledged this 4th day of February, 1932.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

75 United States Board of Tax Appeals. Filed Feb.
23, 1932.

United States Board of Tax Appeals.

Docket No. 21047.

NEW YORK, CHICAGO & ST. LOUIS RAILROAD Co., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

*Notice to Clerk to Prepare Record and Transmit it to
Court of Appeals.*

To the Clerk of the Board of Tax Appeals:

In accordance with paragraph 4 of Rule 30 of the Court of Appeals of the District of Columbia, please prepare a transcript duly certified as correct of the following documents and transmit the same on or before the expiration of six months from February 4, 1932, to the Clerk of the said Court of Appeals:

1. The docket entries of the proceeding before the Board.
2. The pleadings before the Board—
 - (a) Petition.
 - (b) Answer.
 - (c) Amended petition.
 - (d) Answer to amended petition.

- (e) Amendment to answer to amended petition relating to paragraphs 5(d) and 5(g) of amended petition.
- 76 3. Findings of fact and decision of Board.
4. Judgment of the Board entered on August 18, 1931.
5. Respondent's motion to reopen the case and to vacate judgment granted December 7, 1931.
6. Petitioner's consent to modification of the report and judgment of the Board.
7. Order modifying the report and judgment of the Board, entered January 19, 1932.
8. Stipulation under paragraph (d), Section 1002, Revenue Act of 1926, that the review shall be by the Court of Appeals of the District of Columbia.
9. Petition for review and notice to opposing counsel, together with acknowledgment thereof.
10. This notice to Clerk of the Board to prepare and transmit the record, together with acknowledgment of opposing counsel.

ADRIAN C. HUMPHREYS,
NEWTON K. FOX,
Attorneys for the Petitioner.

Service of the foregoing notice is hereby acknowledged this 23rd day of February, 1932.

C. M. CHAREST,
Attorney for the Respondent.

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Docket No. 21047.

NEW YORK, CHICAGO & ST. LOUIS RAILROAD Co., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Certificate.

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 1 to 76, inclusive, contain and are a true copy of the transcript of record, papers and proceedings on file and of record in my office as called for by the Præcipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 15th day of March, A. D. 1932.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk.

Endorsed on cover: Board of Tax Appeals. No. 5638. New York, Chicago & St. Louis Railroad Company, appellant, vs. David Burnet, Commissioner of Internal Revenue. Court of Appeals, District of Columbia. Filed Mar. 19, 1932. Henry W. Hodges, Clerk.

(1891)

COURT OF APPEALS
DISTRICT OF COLUMBIA
FILED

OCT 5 - 1932

Court of Appeals *Henry W. Hodges*
CLERK

OF THE DISTRICT OF COLUMBIA.

No. 5638.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD
COMPANY,

Appellant,

VS.

DAVID BURNET, COMMISSIONER OF INTERNAL
REVENUE,

Appellee,

BRIEF FOR APPELLANT.

ADRIAN C. HUMPHREYS,
NEWTON K. FOX,
Munsey Building,
Washington, D. C.,
42 Broadway,
New York, N. Y.

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Court of Appeals

OF THE DISTRICT OF COLUMBIA.

No. 5638.

THE NEW YORK, CHICAGO & ST. LOUIS RAILROAD COMPANY,
Appellant,

vs.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Appellee.

BRIEF FOR APPELLANT.

Statement of the Case.

This is a proceeding to review a decision of the United States Board of Tax Appeals (23 B. T. A. 177) and orders and judgments entered thereon redetermining the Federal income tax liability of the Appellant for the calendar year 1917 (R. 57-58).

Pursuant to Section 1002(d) of the Revenue Act of 1926 the parties agreed that the review be in this Court and a stipulation to that effect was filed (R. 59).

The case involves the determination of the amount of Federal income tax payable by the Appellant for the year 1917 under the provisions of the Revenue Act of 1916 (39 Stat. 756, c. 463) as amended by the Revenue Act of 1917 (40 Stat. 300, c. 63).

The questions involved are:

(1) Whether there was bond discount on the issuance by the Appellant of its First Mortgage 4% Coupon Gold Bonds which should be amortized over the life of the bonds, and,

(2) The amount of profit, if any, upon the purchase for retirement by Appellant during the year 1917 of certain of its First Mortgage 4% Coupon Gold Bonds.

The case was heard by the Board on October 30, 1930 on the pleadings and a stipulation of facts (R. 2, 25-26).

On May 13, 1931 the Board rendered its opinion finding for the Appellee on the first issue and for the Appellant on the second issue (R. 24-25, 49-55).

On August 18, 1931 the Board entered its order and judgment determining an overpayment of income tax by the Appellant for the year 1917 in the sum of \$1,462.83 (R. 55).

On November 30, 1931 the Appellee moved to set aside and vacate the order entered on August 18, 1931 as to the second issue on the authority of *Kirby Lumber Co. v. United States*, 284 U. S. 1 (R. 56). The motion was granted December 7, 1931 (R. 56) and on January 19, 1932 a consent was filed by the Appellant to the modification of the Board's decision and judgment (R. 57). The consent, however, reserved the right to a redetermination of the amount of profit resulting from the purchase in 1917 for retirement of Appellant's bonds in the event of a final decision that there was a discount incident to the issuance of the First Mortgage 4% Gold Coupon Bonds (R. 57).

On January 19, 1932 the Board entered a new judgment determining an overpayment of income taxes by the Appellant for the year 1917 in the sum of \$445.33 (R. 58).

Petition for review of the judgment of the Board was filed February 4, 1932 (R. 59).

Facts.

The facts were stipulated before the Board (R. 26-49) and may be summarized as follows.

The New York, Chicago and St. Louis Railway Company (referred to as the Railway Company) being in receivership due to failure to pay interest on its first and second mortgage bonds, the Circuit Court for the County of Cuyahoga, State of Ohio, on January 4, 1887 declared the conditions stated in the mortgages had been breached.

It was necessary for the bondholders, stockholders and creditors to work out a plan for recapitalization and reorganization and this was done by a Plan of Reorganization entered into on February 4, 1887 by and between the holders of first and second mortgage bonds, holders of preferred and common stock, sundry creditors of the Railway Company and a Purchasing Committee designated and appointed by the bondholders, stockholders and creditors.

Pursuant to the Plan of Reorganization the Purchasing Committee secured the deposit of the required percentage of bonds and stock of the Railway Company and declared the Plan operative. Under the Plan the Purchasing Committee was authorized to secure a sale of the properties of the Railway Company and to organize a company or companies for the purpose of taking over the railway properties, rights and franchises, in exchange for which the Purchasing Committee was to receive a stipulated amount, par value, of bonds and capital stock of the new company or companies to be distributed by the Purchasing Committee to the assenting bondholders and stockholders of the old company.

All of the steps provided in the Plan of Reorganization were carried out meticulously. As provided in the order of Court there was a sale as an entirety without appraisal of the Railway Company's properties to the Purchasing Committee. The Purchasing Committee then organized separate corporations in each of the states in which the

properties were located, following which it consolidated the constituent companies into the Appellant Company and received from the Appellant its First Mortgage 4% Coupon Gold Bonds of an aggregate par value of \$20,000,000, and First and Second Preferred and Common Stock of a total par value of \$30,000,000.

Of the total of Appellant's First Mortgage 4% Coupon Gold Bonds, \$16,800,000 par value were disposed of by the Purchasing Committee to former holders of the First Mortgage Bonds of the Railway Company who had deposited a total of \$15,000,000 par value of said Railway Company bonds on the basis of \$1,120.00 par value for each \$1,000.00 par value bond deposited.

Of the total of Appellant's First Mortgage 4% Coupon Gold Bonds, \$1,155,830.00 par value were disposed of to former holders of old Second Mortgage Bonds of the Railway Company, who had deposited a total par value of \$1,046,000.00, on the basis of \$1,105.00 par value for each \$1,000.00 bond deposited.

The remaining portion of Appellant's First Mortgage 4% Coupon Gold Bonds of a par value of \$2,044,170.00 were delivered to and for the use of the Appellant.

The Appellant's First and Second Preferred ^{and Common} Stock, of a par value of \$30,000,000 was likewise disposed of by the Purchasing Committee as provided by the Plan of Reorganization. Its distribution is immaterial to the issues in this case (which involve bond discount) except to show that the Plan of Reorganization was carried out in every particular.

Questions Involved.

Was the difference of \$1,909,830 (between the aggregate of \$17,955,830 par value First Mortgage 4% Coupon Gold Bonds of Appellant issued to refund bonds of the Railway Company aggregating \$16,046,000 par value) discount incident to the issuance of said bonds, a pro rata

amount of which is deductible annually over the life of the bonds?

If the sum of \$1,909,830 is held to be discount, the Appellant is entitled to a deduction from gross income for the year 1917 of \$35,045.58 (R. 49, 51).

If the Court decides that there was bond discount, the profit upon the purchase for retirement by Appellant during the year 1917 of certain of its First Mortgage 4% Coupon Gold Bonds must be recomputed.

Assignments of Error.

(1) The Board erred in holding that the separate steps taken in pursuance of the Plan of Reorganization were controlling rather than the object and execution of the Plan as a whole.

(2) The Board erred in ruling that the form of the reorganization rather than the substance was controlling.

(3) The Board erred in holding, contrary to the stipulated facts, that "The petitioner was organized in 1887 as the result of a compulsory reorganization of the ownership and financial structure of the railroad properties."

(4) The Board erred in holding that Petitioner's First Mortgage 4% Coupon Gold Bonds were issued in part payment of the railroad properties.

(5) The Board erred in failing and refusing to hold that Petitioner issued its First Mortgage 4% Coupon Gold Bonds in 1887 at a discount.

(6) The Board erred in failing and refusing to reduce the amount of profit resulting from the purchase by the Petitioner in 1917 of certain of its First Mortgage 4% Coupon Gold Bonds by the amount of unamortized discount on said bonds at the date of purchase. (This is an automatic audit adjustment which will result from

a reversal of the Board's decision on the bond discount question).

(7) The Board erred in not entering judgment for the Petitioner in a greater amount as an overpayment of income taxes for the year 1917.

Statute Involved.

This case arises under the provisions of the Revenue Act of 1916 (39 Stat. 756, c. 463) as amended, as to the rates of tax, by the Revenue Act of 1917 (40 Stat. 300, c. 63) and particularly the following sections of the Revenue Act of 1916 which allow corporations a deduction from gross income of interest "paid" (Sec. 12(a) Third) or "accrued" (Sec. 13(d)) on its indebtedness:

"Sec. 12(a) Third. The amount of interest paid within the year on its indebtedness * * *"

"Sec. 13(d). A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned."

The Appellant kept its accounts on the accrual basis (R. 26).

As bond discount is "interest," a pro rata amount is deductible annually over the life of the bonds and if Appellant issued its bonds at a discount, it is entitled to a deduction for the year 1917 of \$35,045.38 (R. 49, 51). *Western Maryland Ry. Co. v. Commissioner*, 33 Fed. (2d) 695; *Chicago, Rock Island & Pacific Ry. Co. v. Commissioner*, 13 B. T. A. 988.

ARGUMENT.

I. The stipulated facts show that the bonds of appellant were issued pursuant to a reorganization at a discount.

The facts were all stipulated before the Board of Tax Appeals and are of particular importance in showing that the bonds were issued by the Appellant Railroad Company pursuant to a reorganization of the Railway Company at a discount. For that purpose they will be stated more fully than in the opening statement of facts particularly to show that the decision of the Board of Tax Appeals is based upon erroneous conclusions drawn from the stipulated facts.

This covers the first four assignments of error.

The Appellant is a railroad corporation organized in September 1887. It was created by a consolidation of The New York, Chicago & St. Louis Railroad Company, a corporation existing under the laws of the States of New York and Pennsylvania, The Cleveland & State Line Railroad Company, a corporation existing under the laws of the State of Ohio, The Fort Wayne & Illinois Railroad Company, a corporation existing under the laws of the State of Indiana, and The Erie & State Line Railroad Company, a corporation existing under the laws of Pennsylvania (R. 26).

The purpose of the organization of the Appellant was to effect a reorganization of the New York, Chicago & St. Louis Railway Company, under a Plan or Reorganization entered into on February 4, 1887.

Prior to February 4, 1887, the New York, Chicago & St. Louis Railway Company was in the hands of a receiver and in default of the payment of interest on its First and Second Mortgage Bonds. On February 4, 1887, a Plan of Reorganization was entered into by the holders

of the First and Second Mortgage Bonds, the holders of preferred and common capital stock and sundry creditors of the Railway Company and a Purchasing Committee appointed by and composed of bondholders, stockholders and creditors of the Railway Company.

Pursuant to the Plan, the Purchasing Committee caused new corporations to be formed under the laws of the several states of Ohio, Indiana, Illinois, New York and Pennsylvania with power to acquire all the property and franchises which the said Purchasing Committee held. The Purchasing Committee had the power and authority to convey the franchises and properties to be purchased by them to such new companies or a consolidated company and to receive in payment the following securities:

First Mortgage Bonds.....	\$20,000,000.00
First Preferred Stock.....	5,000,000.00
Second Preferred Stock.....	11,000,000.00
Common Stock	14,000,000.00

The holders of First Mortgage Bonds and Second Mortgage Bonds of the Railway Company deposited their bonds with the Central Trust Company of New York, depository of the Purchasing Committee, and agreed to accept in lieu thereof transferable certificates of said Trust Company and the assenting stockholders of the Railway Company likewise deposited their stock and cash assessments as provided by the Plan.

The Plan of Reorganization provided that the First and Second Mortgage bondholders should receive an amount of new First Mortgage Bonds of a new company of a principal equal to 112% of the principal of the old First Mortgage Bonds and 110½% of the old Second Mortgage Bonds, together with interest from December 1, 1886 to the date of the new bonds. The holders of the old First Preferred Stock were to receive new First Preferred Stock equal par value to the cash assessment paid in on said old

Preferred Stock and an amount of new Second Preferred Stock equal par value to 50% of the par value of the old Preferred Stock. The holders of the old Common Stock were to receive an amount of new First Preferred Stock equal par value to the cash assessment paid in on said old Common Stock and an amount of new Common Stock equal par value to 50% of the par value of the old Common Stock. The holders of claims were to receive First Mortgage Bonds of the new company to an amount of principal equal to the amount of the face value of the claim and interest or the Purchasing Committee might at its option pay the claim in cash.

The Plan of Reorganization gave the Purchasing Committee full powers in the reorganization of the Railway Company and all powers requisite or in the opinion of the Committee desirable to accomplish the reorganization in addition to the powers specifically enumerated.

On or about April 4, 1887, the Court ordered the Railway Company to pay the amount of the principal and interest due on the First and Second Mortgage Bonds and in default directed the Special Master to sell the properties of the Railway Company as an entirety and without appraisal for not less than \$16,000,000 of which not less than \$100,000 should be paid in cash.

The order permitted the purchasers to satisfy the remainder of the purchase price over and above the cash requirement of \$100,000 by assuming the receiver's expenses and by First and Second Mortgage Bonds and interest thereon in default at such price or value as was equivalent to the amount that the holders thereof would be entitled to receive if the amount of the purchase price was paid in cash.

On May 19, 1887, the properties of the Railway Company were sold by the Special Master to the Purchasing Committee named in the agreement of February 4, 1887 for the sum of \$16,000,000. The Purchasing Committee paid \$100,000 in cash and elected to pay the balance as

provided in the Plan by paying over and surrendering certain indebtedness of the receiver and the First Mortgage Bonds of the Railway Company as permitted by the order of the court.

On May 21, 1887 the Court ratified and confirmed the sale and upon payment of the balance of the purchase price the Special Master executed a deed conveying the property of the Railway Company to the Purchasing Committee.

The Fort Wayne & Illinois Railroad Company was organized under the laws of Indiana on June 27, 1887 by the Purchasing Committee and their associates for the purpose of maintaining and operating the properties of the Railway Company located in that state.

The Chicago & State Line Railroad Company was organized under the laws of Illinois on June 16, 1887 by the Purchasing Committee for the purpose of acquiring the properties of the Railway Company located in that state.

The Cleveland & State Line Railroad Company was organized under the laws of Ohio on August 13, 1887, by certain individuals for the purpose of acquiring the properties from the Purchasing Committee.

The Erie & State Line Railroad Company was organized under the laws of Pennsylvania on June 24, 1887 by the Purchasing Committee for the purpose of maintaining and operating the properties of the Railway Company located in the State of Pennsylvania.

The New York, Chicago & St. Louis Railroad Company was organized under the laws of New York on June 16, 1887, by the Purchasing Committee and their associates for the purpose of acquiring the properties of the Railway Company located in the State of New York.

On July 2, 1887, the Purchasing Committee by deeds conveyed to The Ft. Wayne & Illinois Railroad Company the properties of the Railway Company purchased which were located in the State of Indiana, for \$14,350,000; to The Chicago & State Line Railroad Company the properties of the Railway Company located in the State of

Illinois for \$1,500,000; to Daniel W. Caldwell, Jephtha H. Wade, George A. Garretson, John C. Hale, and Harvey H. Brown the properties of the Railway Company located in the State of Ohio for \$23,550,000; to The Erie and State Line Railroad Company the properties of the Railway Company located in the State of Pennsylvania for \$4,800,000; and to The New York, Chicago & St. Louis Railroad Company the properties of the Railway Company located in the State of New York for \$7,300,000; a total of \$51,500,000.

As consideration for the above transfers the Purchasing Committee received promissory notes except in the case of the Cleveland & State Line Railroad Co. which issued its entire capital stock and a promissory note for the balance to the Purchasing Committee.

On July 7, 1887, by joint agreement, The New York, Chicago & St. Louis Railroad Company and The Erie & State Line Railroad Company were consolidated into a corporation known as The New York, Chicago & St. Louis Railroad Company pursuant to the laws of New York and Pennsylvania.

On August 18, 1887, by joint agreement, The New York, Chicago & St. Louis Railroad Company, The Cleveland & State Line Railroad Company, and The Ft. Wayne & Illinois Railroad Company, were consolidated into a corporation known as The New York, Chicago & St. Louis Railroad Company, the Appellant. This consolidation was duly effected in accordance with the laws of the various states on September 27, 1887.

The authorized capital stock of the Appellant consisted of three hundred thousand shares having a par value of \$30,000,000. Of this \$5,000,000 was first preferred, \$11,000,000 second preferred, and \$14,000,000 common. The entire capital stock was exchanged par for par for the capital stock of the underlying corporations and was issued to the Purchasing Committee who held the capital stock of the underlying corporations. This capital stock

was disposed of by the Purchasing Committee as provided in the Plan of Reorganization.

When the properties of the underlying corporations were taken over by the Appellant they were indebted to the Purchasing Committee in the aggregate sum of \$20,000,000. The Appellant became liable for the payment of this indebtedness, and by resolution of its Board of Directors adopted September 28, 1887, authorized the issue of its First Mortgage 4% Gold Bonds dated October 1, 1887, maturing in 50 years of a par value of \$20,000,000 to be delivered to the Purchasing Committee in payment of the said indebtedness. The action was approved by the stockholders the same day and the bonds were delivered to the Purchasing Committee in payment of the indebtedness.

On October 31, 1887, the bonds were set up on the corporation's books by a charge to cost of road and equipment in the full par value of \$20,000,000.

The Purchasing Committee disposed of the bonds as provided in the Plan of Reorganization as follows:

To holders of old First Mortgage Bonds of the Railway Company in the par value of \$15,000,000 at \$1,120 per bond	\$16,800,000
To holders of old Second Mortgage Bonds of the Railway Company of a par value of \$1,046,000 at \$1,105 per bond	1,155,830
Delivered to and for the use of the new company	2,044,000
Surplus under the Plan of Reorganization to the new company	170
Total	\$20,000,000

Therefore, after the Plan had been executed we have the same bondholders of the old Railway Company and the Appellant the new Railroad Company, the same stockholders of both and the same assets.

1. The Board erred in holding that the separate steps taken in pursuance of the Plan of Reorganization were controlling rather than the object to be attained and the execution of the plan as a whole.

The detailed facts set out above, show that Appellant's bonds were issued as the result of a reorganization of the Railway Company then in receivership.

Viewed as a whole the object of the Plan of Reorganization and its execution are controlling rather than the separate steps taken. While the form of the reorganization was a sale, in reality the consummation of the Plan of Reorganization was the issuance of new bonds of Appellant for the bonds of the old Railway Company through the intermediary of a Purchasing Committee acting as agent for the old bondholders and the Appellant as the acquirer of the properties of the old Railway Company. The form was a sale, the reality was a reorganization under which the bondholders of the old company became the bondholders of the Appellant.

The sale authorized by the Court specified a selling price of \$16,000,000.00 and directed that the sale of the property be made "as an entirety and without appraisal." It was, of course, prearranged that the Purchasing Committee should purchase the property as one of the steps in the reorganization. The only consideration actually paid by the Purchasing Committee was the \$100,000.00, cash assessments deposited by the stockholders assenting to the Plan of Reorganization to defray the expenses of sale and commissions.

The liability to the bondholders under the Plan was not discharged at this point nor could it be discharged except by the issuance of bonds of a new company or companies to be formed. The sale to the Purchasing Committee was purely a formality in carrying out the Plan of Reorganization.

The Purchasing Committee then deeded the properties acquired at the receivership sale to separate corporations which it caused to be organized and upon consolidation of these corporations it received in payment the bonds and stock of the Appellant. The Purchasing Committee was obliged under the Plan of Reorganization to turn these bonds and stock over to the old bondholders and stockholders of the Railway Company as provided in the Plan of Reorganization. It was in no sense acting for itself as a separate entity but was acting solely for the old bondholders and stockholders in relation to the new company, the Appellant, as an agent and clearing house. In other words the liability of the Appellant, the consolidated corporation was a liability to issue its bonds and stock through the Purchasing Committee to the old stockholders and bondholders of the Railway Company.

As stipulated, five separate corporations were first organized under the laws of the States of Illinois, Indiana, Ohio, Pennsylvania and New York, and in five separate deeds dated July 2, 1887 the Purchasing Committee made the conveyances at a specified price.

The total consideration was \$51,500,000.00. As the result of two successive consolidations all of the companies, with the exception of the Chicago & State Line Railroad Company, were consolidated into the Appellant.

The Chicago & State Line Railroad was leased in perpetuity to the Fort Wayne & Illinois Railroad Company, one of the members of the consolidated group. The consideration recited in the deed to the Chicago & State Line R. R. Company was \$1,500,000.00, which amount subtracted from the total consideration \$51,500,000.00 leaves the sum of \$50,000,000.00. That was the capitalization provided for in the Plan of Reorganization, and was the capitalization of the Appellant, the consolidated company, consisting of \$30,000,000.00 in capital stock and \$20,000,000.00 in First Mortgage Bonds.

The Appellant, through the medium of the Purchasing Committee, issued \$16,800,000.00 of its First Mortgage Bonds to refund \$15,000,000.00 of First Mortgage Bonds of the Railway Company, or an excess of \$1,800,000.00, and \$1,155,830.00 of Appellant's First Mortgage Bonds were issued to refund \$1,046,000.00 of old Second Mortgage Bonds of the Railway Company resulting in an excess payment of \$109,830.00. The total excess in these two instances of \$1,909,830.00 is claimed as a discount on the First Mortgage 4% Coupon Gold Bonds of the Appellant. The effect is the same as if the Appellant had sold \$17,955,830.00 of its First Mortgage Bonds for \$16,046,000.00 and with those proceeds paid off the bonds of the Railway Company. That purpose was actually accomplished. The Purchasing Committee was the agent and clearing house for all parties.

In final analysis the transaction was a reorganization pursuant to which the bonds of the old Railway Company were exchanged for the new bonds of the Appellant—at a discount.

2. The substance not the form of the transaction is controlling.

In the case at bar the new bonds of appellant were issued to the bondholders of the Railway Company to refund the outstanding bonds of the Railway Company. Looking through form to substance, as did the Circuit Court of Appeals for the Fourth Circuit in the case of *Western Maryland Railway Company v. Commissioner*, 33 Fed. (2d) 695, the Railway Company bonds were exchanged for an issue of greater par value than the amount of the old bonds. Clearly the new bonds of Appellant were issued at a discount—just as much as though they had been sold for cash at less than par.

As was said by the Circuit Court of Appeals in the *Western Maryland Ry. Case (supra)*:

"In the first place, it is perfectly clear that, although there has been a reorganization and although the consolidated corporation is a distinct legal entity from those whose places it has taken, nevertheless, in all of its essential relationships, it occupies exactly the same position which they occupied. Its management is the same, its assets are the same, its stockholders are the same, and its obligations are the same, except that the floating indebtedness of the old corporation has been taken up by the first preferred stock of the new, a change which might have been effected by the old corporation without reorganization, and which manifestly can have no bearing upon the matter of bond discount. In other words, the consolidated corporation has stepped into the place of the corporation which issued the bonds, and occupies the same relationship towards them that it occupied. It has received no consideration for its agreement to pay them except the assets of the old corporation which have been transferred to it. It has the same property as the old corporation, owes the same bonded debt, and is bound to pay it in the same way. * * *

"After all, while there is a technical legal difference between the old and the new corporations, they are the same as a practical matter, both holding the same property and representing the same ownership, and it is a settled principle that 'courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require.' *Chicago, Milwaukee & St. Paul R. Co. v. Minneapolis Civic Ass'n.*, 247 U. S. 490, 501, 38 S. Ct. 553, 557 (62 L. Ed. 1229); *Southern Pac. Co. v. Lowe*, 247 U. S. 330, 38 S. Ct. 540, 62 L. Ed. 1142; *Gulf Oil Corporation v. Lewellyn*, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133" (pp. 697-698).

The same points of similarity exist between the Appellant and the Railway Company as existed between the reorganized corporation and its predecessors in the *Western Maryland* case. Looking through form to the sub-

stance, in order to determine *what was done*, rather than how it was done, we find that the Railway Company refunded its outstanding liability of a par value of \$16,046,000.00 by the exchange of bonds of the Appellant of a par value of \$17,955,830.00. Appellant thereby suffered a discount of \$1,909,830.00. It is true that in order to effect this there was a complicated reorganization but in substance, and for all practical purposes, the same company, owned and controlled by the same stockholders, owning and controlling the same properties, and having the same bondholders, was the result.

Substance rather than form is controlling in matters of taxation. (*Weiss v. Stern*, 265 U. S. 242; *U. S. v. Phellis*, 257 U. S. 156; *Eisner v. Macomber*, 252 U. S. 189; *Gulf Oil Corporation v. Lewellyn*, 248 U. S. 71; *Alpha Portland Cement Company v. U. S.*, 261 Fed. 339; *Taber vs. United States*, 59 Fed. (2nd) 568, 571.

In the *Western Maryland Ry. Co.* case the Court said:

“We think, therefore, that, as the new corporation, while technically a distinct legal entity, is to all practical intents and purposes a mere continuation of the old, it is entitled to the same deduction on account of amortized bond discount that the old corporation would have been entitled to, if the reorganization had not taken place” (p. 698).

Under the facts of the case at bar and under the authority of the *Western Maryland Ry.* case the form of the reorganization is not controlling. The Appellant Company for all practical purposes is a successor to the predecessor company by reorganization and should not be denied an annual deduction for bond discount on the issuance of its bonds in refunding the bonds of the old company.

The question may well be considered from the viewpoint of the individual bondholder. He deposited his bonds under the Plan of Reorganization and received a certificate en-

titling him to participate in the benefits of the Plan. When the new First Mortgage Bonds of Appellant were issued he received from the Purchasing Committee the new First Mortgage Bonds. He received a new bond in the refunding of the old bond. The Purchasing Committee was the agent of both parties—in effect nothing more than a clearing house for the refunding of the old bonds.

Appellant issued stock for stock and bonds for bonds pursuant to the Plan of Reorganization, devised by the bondholders and stockholders and executed by a Purchasing Committee composed of the stockholders and bondholders. In the refunding of the Railway Company, the Appellant obligated itself to pay at maturity a liability in excess of the consideration it received, namely, the cancellation by the issuance of its new bonds of the liability represented by the old bonds of the Railway Company. That excess constitutes bond discount.

3. The Board erred in holding, contrary to the stipulated facts, that “the petitioner was organized in 1887 as the result of a compulsory reorganization of the ownership and financial structure of the railroad properties.”

There was nothing “compulsory” about the reorganization of the Railway Company other than occurs in the usual case of a railroad receivership. Interest was in default and the practical solution was a Plan of Reorganization. As a result, the bonds of Appellant were issued at a discount to the bondholders of the Railway Company. Whether “compulsory” or voluntary, there is no particular difference when the final result is the issuance of bonds at a discount. *Western Maryland Case (supra)*.

But it was in fact a purely voluntary Plan entered into and assented to by the old bondholders and stockholders otherwise the Plan could not have been declared operative. There was in fact mutual assent by all parties concerned and the Plan as agreed to was followed and carried out in

every detail and with particularity. The whole scheme, with the Purchasing Committee as the operating agency in the reorganization, was "voluntary", assented to, planned, and carried out. The old bondholders of the Railway Company received the bonds of the Appellant as the result of refunding the old bonds of the Railway Company.

4. The Board erred in holding that petitioner's First Mortgage 4% Coupon Gold Bonds were issued in part payment of the railroad properties.

Looking at the transaction as a whole the entire scheme was to refund old bonds by new bonds. That was the ultimate result. The old bondholders were in fact, after the details of the reorganization had been completed, the bondholders of the Appellant—bond for bond. There were no new elements in the reorganization—the parties were the same—the ownership per share was proportionately the same. The Purchasing Committee and the sale were merely a form or means to an end, a method of accomplishing the ultimate purpose of issuing the bonds of Appellant to the bondholders of the Railway Company to refund the old bonds.

While in form a purchase and sale, in reality the Appellant issued its bonds to the bondholders of the old Railway Company at a discount. The bondholders of the old company became bondholders of the new. Identity of the old and new bondholders was the same.

II. The Board erred in failing and refusing to hold that appellant issued its first mortgage 4% coupon gold bonds in 1887 at a discount.

With reference to the fifth assignment of error, the facts in the *Western Maryland* case (*supra*) differ in no fundamental particular from the facts in the case at bar

and the principles announced in that decision are controlling in the case at bar. Once substance and not the form of the transaction is considered, the decision in the *Western Maryland* case entitles the Appellant to a deduction for bond discount.

The Board misinterpreted and refused to follow the *Western Maryland* case in holding that the Appellant's bonds were not issued at a discount. The decision of the Circuit Court in that case was not based on the facts of the assumption by the new company of the liabilities of the old company.

The broad principles announced by the Court in that case cover the issues in this case and establish the right of the Appellant to the deduction claimed. It is immaterial under that decision that the properties were acquired in the case at bar in the form of a purchase and sale by the Purchasing Committee and an exchange by the Purchasing Committee of the properties to the Appellant for its bonds. The substance of the transaction was an agreement by the old bondholders, under the Plan of Reorganization, to accept the bonds of the Appellant for the bonds deposited and the Purchasing Committee, as Agent for both parties, carried out the Plan.

Once form is disregarded and substance considered, as was done in the *Western Maryland* case, the only objection to the allowance of discount by the appellee is removed. Had this transaction been a refunding of existing bonds by new bonds of a greater par value *by the same company*, the Appellee, consistent with the practice in other cases, would have allowed the discount represented by the difference in par value.

The sophistry of the Board's opinion and the meticulous attempt through emphasis of non-essential details to differentiate the case at bar from the *Western Maryland* case and the refusal of the Board to recognize and follow the broad principles announced by the Court in that case are

well summed up in the dissenting opinion, in the case at bar, of Board Member Trammell as follows:

“Even conceding that assets were acquired or paid in for bonds, in my opinion, it does not necessarily follow that the bonds were not issued at a discount. Clearly, if the owner of the property had agreed to take the bonds for the property at a discount we could not say that there was no discount and it would have been amortizable, but instead of agreeing specifically to receive the bonds at a discount, the question is, Did not what actually occurred amount to the same thing? In other words, were not the bonds actually taken at a discount? I think so. What actually occurred, it seems, was that the bonds were issued and taken at less than their face value. I do not consider that it is important that property was received instead of cash. If the owner of the properties had said that they would give their property for the bonds at a discount of a certain per cent, the case would be clear. Instead of doing so, it was agreed to give bonds for property worth less, the same result as if cash less than the face of the bonds had been received. I see no reason why discount on bonds is limited to borrowed money. If a person had property to sell and agreed to take \$9,500 cash for it or \$10,000 par value of bonds to be issued and taken at 95, it seems to me that if the bonds were taken it could not be said that there was no discount on the bonds simply because property was acquired instead of cash borrowed. As said in the prevailing opinion, we should not let the word ‘discount’ run away with us, but should consider the facts in the present case” (R. 54-55) (23 B. T. A. 177, 198-199).

III. The Board erred in failing and refusing to reduce the amount of profit resulting from the purchase by the appellant in 1917 of certain of its first mortgage 4% coupon gold bonds by the amount of unamortized discount on said bonds at the date of purchase.

With reference to the sixth assignment of error, if the decision of the Board on the question of bond discount is reversed, then the determination of Appellant's tax liability for the year 1917 and particularly the profit resulting from the purchase by Appellant in 1917 of certain of its bonds, will require an adjustment to be made on re-audit. This, of course, is automatic if the Board is reversed.

CONCLUSION.

It is submitted that the bonds of Appellant were issued at a discount, that the case at bar is controlled by the *Western Maryland* decision and that the Board of Tax Appeals should be reversed.

Appellant is entitled to a deduction for bond discount of \$35,045.58 for the year 1917.

Respectfully submitted,

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No. 5638

FEB 6 - 1933

Henry H. Woodger

In the Court of Appeals of the District of
Columbia

JANUARY TERM, 1932

NEW YORK, CHICAGO & ST. LOUIS RAILROAD
COMPANY, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL
REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The only previous opinion in the present case is that of the United States Board of Tax Appeals (R. 24), which is reported in 23 B. T. A. 177.

JURISDICTION

The appeal in this case involves income taxes for the year 1917 in the amount of \$2,102.72,¹ and

¹ Representing a tax of 6 per cent on \$35,045.38, the amortized discount, which the Commissioner disallowed.

is taken from an order of redetermination by the United States Board of Tax Appeals promulgated on January 19, 1932. (R. 58.) The case is brought to this Court by petition for review filed on February 4, 1932 (R. 59), pursuant to the Revenue Act of 1926, c. 27, Sections 1001, 1002, 1003, 44 Stat. 9, 109, 110.

QUESTION PRESENTED

Whether under the stipulated facts in this case the taxpayer's bonds were issued at a discount.

STATUTE INVOLVED

Revenue Act of 1916, c. 463, 39 Stat. 756:

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

* * * * *

Third. The amount of interest paid within the year on its indebtedness * * *.

STATEMENT

The stipulation of facts, which was adopted as the findings of fact by the Board of Tax Appeals, may be briefly summarized as follows (R. 26-49):

The taxpayer was organized in September, 1887, following a receivership of its predecessor, which defaulted in the payment of interest on its bonded indebtedness amounting to \$16,046,000. (R. 26,

47.) In April, 1887, and as a result of the receivership proceedings, the court decreed that the property of its predecessor be sold for not less than \$16,000,000. (R. 41-42.) In February, 1887, the bondholders, stockholders, and creditors of its predecessor, in order to protect their interests, entered into an agreement for a purchasing committee to bid in the property. The agreement further provided for the sale of the property by the purchasing committee to certain new railroad companies, for the consolidation of the new companies, and for the distribution of the stock and bonds of the consolidated company. (R. 27-41.)

In May, 1887, the property was sold to the purchasing committee under order of court for \$16,000,000, and a deed was executed conveying the property to the purchasing committee. The purchasing committee sold the property in parcels to separate corporations, and took their notes and stock in return. (R. 42-43.) In September, 1887, the separate companies were consolidated into the taxpayer. (R. 44.)

When the taxpayer took over the underlying companies, they were indebted to the purchasing committee in the aggregate sum of \$20,000,000, which represented a part of the purchase prices of their several lines of railway, the balance having been previously paid by the issuance of capital stock. In order to meet its obligation for this indebtedness, the day after the taxpayer was organized it issued \$20,000,000 of its First Mortgage 4

per cent bonds, maturing in fifty years, which were delivered to the purchasing committee in satisfaction of the taxpayer's indebtedness. (R. 47.)

Pursuant to the agreement of February, 1887, the purchasing committee distributed bonds of the taxpayer in the amount of \$17,955,830 to the holders of \$16,046,000 of bonds in the predecessor company. (R. 47.) Taxpayer claimed that the difference between \$17,955,830 and \$16,046,000 represents discount, and that it has the right to deduct \$35,045.38 (representing one-fiftieth of the difference or the amortized discount) for the year 1917. (R. 48.) The taxpayer keeps its books on the accrual basis. (R. 26.) The Commissioner disallowed the deduction and determined a deficiency, of which the taxpayer sought a redetermination by the Board of Tax Appeals. The Board—one member dissenting—upheld the Commissioner. The parties stipulated that the Board's decision might be reviewed by this Court. (R. 59.)

ARGUMENT

Under the stipulated facts in this case, the taxpayer's bonds were not issued at a discount

The facts were stipulated by the parties, and part of this stipulation, which was incorporated in the findings of fact by the Board of Tax Appeals, is as follows (R. 47):

When the properties of the aforesaid underlying corporations were taken over by the consolidated corporation, The New York,

Chicago & St. Louis Railroad Company (the petitioner in this proceeding), they were indebted to the purchasing committee in the aggregate sum of \$20,000,000.00, such sum being a part of the purchase prices of their several lines of railway and other property, the balance of such purchase prices having previously been paid by the issuance of such corporations' capital stock. The New York, Chicago & St. Louis Railroad Company became liable for the payment of this indebtedness, and in order to meet its obligations thereon its board of directors by resolution duly adopted September 28, 1887, authorized the issue of its First Mortgage 4% Coupon Gold Bonds dated October 1, 1887, maturing in 50 years in the par value of \$20,000,000.00 to be delivered to the purchasing committee in payment of the said indebtedness. This action of the board of directors was duly approved by the stockholders at a meeting held on the same date. The bonds were thereupon delivered to the purchasing committee in satisfaction and payment of the indebtedness.

In other words, the stipulation of facts shows that when the taxpayer took over the properties of the constituent companies, it became liable for the payment of \$20,000,000 to the purchasing committee, and that in payment of this indebtedness it issued \$20,000,000 of its bonds and delivered them to the purchasing committee. (R. 47.) This clearly indicates that the bonds were issued at par,

and not at a discount. What the purchasing committee did with the bonds after the taxpayer delivered them has no bearing on the question whether or not they were issued by the taxpayer at a discount.

The taxpayer's answer to this argument is that substance rather than form should control, and that inasmuch as taxpayer's bonds in the par value of \$17,955,830 were distributed to holders of bonds in its predecessor company in the par value of \$16,046,000, the bonds were issued at a discount of \$1,909,830. In support of this proposition, *Western Maryland Ry. Co. v. Commissioner*, 33 F. (2d) 695 (C. C. A. 4th) is cited. (Br. 6, 15-16, 17, 18, 19-20.) As the Board pointed out in its opinion, the *Western Maryland* case is clearly distinguishable (R. 50):

There was no assumption by the petitioner of the old liability. From the default had sprung the remedy of discharge and the court had required that such remedy be enforced. Whatever may have been the terms of the old bonds, the financial means for performing them, or the method of accounting in respect of them, they necessarily came to an end with the discharge of the bonds. While to the bondholder it may perhaps have been of little practical moment whether there was a continuation of the old debt or a substitution of a new, this does not serve to wash out the legal steps and results which it required all of the machinery of the law to bring about.

The situation is, in this respect, quite different from that in *Western Maryland Railway Company v. Commissioner*, 33 Fed. (2d) 695, cited by petitioner, where the reorganization successor assumed the predecessor's obligation of the old bonds and the court held that in the detail circumstances the tax deduction for amortization ran with the obligation despite the substitution of the new obligor. Because the discounted bonds carried through the reorganization, it was held that the effect of the discount went with it.

In the instant case the bonds of the predecessor company were discharged before the taxpayer was organized, whereas in the *Western Maryland case* the old bondholders continued to hold the same bonds and the new corporation assumed the obligations of the old. There are statements in the taxpayer's brief to the effect that the bondholders of the taxpayer are the same as the bondholders of the old corporation. (Br. 12, 17, 19.) There is no evidence in the record to support this statement. In the instant case, the predecessor company was in default and its property was sold under order of court (R. 26-27, 41-42), so that the old company had no choice other than to discharge the bonds, while in the *Western Maryland case*, there is nothing to show why the old company could not have continued in existence.

In a recent case in the Supreme Court, a taxpayer sought to do the same thing as the taxpayer in this case. After having utilized a corporate entity

to secure certain advantages under state laws, he wanted to disregard the corporate entity for purposes of Federal taxation on the same ground that the taxpayer invokes in this case the substance and not the form of the transaction should control. The court refused to disregard the corporate entity for purposes of Federal taxation. *Burnet v. Commonwealth Improvement Co.*, No. 95, Oct. Term, 1932, decided December 12, 1932, and not yet officially reported, but may be found in 323 C. C. H., p. 9472.

Even if the principle of the *Western Maryland case* should be applied to the circumstances of this case, it would not help the taxpayer. The rule laid down in that case is as follows: since the new corporation, while a distinct legal entity, is to all intents and purposes a mere continuation of the old, it is entitled to the same deduction on account of amortized bond discount that the old corporation would have been entitled to, if the reorganization had not taken place. Accordingly, in the instant case, the deduction would not be based upon the difference between \$17,955,830 and \$16,046,000 (Br. 15, 17), but between \$16,046,000 and the price at which the old bonds were issued. Therefore it would be necessary to show when the bonds of the old company were issued, the maturity of the bonds, and the discount, if any, at which they were issued. There is no evidence in the record as to any of these facts. For all that the record shows, the bonds of the old company may have been issued at a premium.

CONCLUSION

The decision of the Board of Tax Appeals is correct and should therefore be affirmed.

Respectfully submitted.

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